

CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

RAYMOND LIMITED vs. DEPUTY COMMISSIONER OF INCOME TAX

ITAT, MUMBAI 'C' BENCH

R.V. Easwar, J.M. & G.D. Agarwal, A.M.

ITA Nos. 1225 & 1226/Mum/2000

24th April, 2002

(2003) 80 TTJ (Mumbai) 120 : (2003) 86 ITD 791

Case pertains to

Asst. Year 1998-99

TDS—Payment to non-resident—Commission to lead managers of GDR issue—Assessee-company engaged ML, a company incorporated in U.K. as "lead manager" and some other foreign companies as "managers" to the proposed issue of Global Depository Receipts (GDRs) in the international market—It could not be said that there was sale of GDRs to the lead manager/managers and that they had "resold" them to the ultimate investors—They did not "subscribe" to the GDRs—Consequently, it cannot be said that the amounts paid viz., selling concession/commission, underwriting commission and management commission or deducted by them from the sale proceeds of GDRs represented only sale discount—Also, it cannot be said that the assessee-company obtained a "finished package" (marketed GDR issue) in return for what was paid to the lead manager/managers—Consequently, the payment cannot be considered as purchase price of "finished package"—Services rendered by the lead manager/managers in connection with the GDR issue are "managerial" or "consultancy" services and fall within the meaning of "technical services" under s. 9(1)(vii) r/w Expln. 2 thereto—Therefore, management commission and selling concession/commission were income deemed to accrue or arise in India—However, the underwriting services are not "technical" services and, therefore, the underwriting commission did not fall within s. 9(1)(vii), insofar as it related to issue of GDRs outside USA—As regards GDRs issued in USA to qualified institutional buyers, there was no underwriting and, therefore, underwriting commission paid therefor was income by way of fees for technical services deemed to accrue or arise in India—However, all the payments viz. management commission, underwriting commission or the selling commission/concession do not fall within the definition of "fees for technical services" under art. 13.4(c) of the DTAA with U.K. which is applicable to the facts of the case and were not taxable in India—Consequently, assessee-company was not liable to deduct tax under s. 195 from the payments and cannot be treated as an assessee in default under s. 201—Interest under s. 201(1A) could not be charged

Held

An underwriter is one whose business it is to guarantee that the issue would be subscribed fully or to the extent of his share and the question of his buying the shares would come up only if the issue is not subscribed fully or to the extent of his share which he has underwritten. It is only then that he is liable to acquire the shares remaining unsubscribed which he may hold on to or disgorge depending on market conditions. In such a situation it is difficult to hold, merely because of the underwriter's obligation to buy the shares under a certain contingency, that the arrangement with

him is one for sale of shares to him and resale by him to the investors. It is difficult to hold that though there were firm commitments prior to 9th Nov., 1994 for the purchase of the GDRs from qualified institutional buyers still it must be held, on the strength of certain documentation between the parties where the words "resale" (with its grammatical variations) or "reoffer" are coined that there is a sale first to the managers and then by them to the investors. If the GDRs are to be considered as having been purchased by the managers and sold by them to the investors the whole exercise of the managers rendering a variety of services to the assessee becomes meaningless. The possibility that the potential investors may not have heard the name of the Indian company and would, therefore, hesitate to invest in its GDRs and it is only because the well-known firms of ML, GS and DSP, etc. are involved that they would invest in them does not lead to the result that those managers had purchased the GDRs for resale. It would be unreasonable to imagine a situation where though potential investors would hesitate to buy the assessee-company's GDRs, but the managers, who are experts in the line, would take the plunge and purchase them in the hope of reselling them. The better view to take in this case is to hold that the "purchase and resale or subscription" theory cannot possibly be given effect to. Even taking into account all the relevant documents, it is difficult to accept the "resale or subscription" theory. As rightly pointed out on behalf of the Revenue, if it was a case of a simple sale of the GDRs to ML and thereafter a sale by them to the investing public, there is no need for such meticulous documentation defining the rights and duties of the concerned parties with regard to the services to be rendered by each of them in connection with the GDRs. There was also no need for the assessee to participate in the road shows. There was perhaps not even the need to issue an offering circular, which is in the nature of a prospectus giving complete details about the assessee-company. There was no question of the assessee paying 3 per cent or 4 per cent of the sale proceeds as selling commission and reimbursing certain expenses to the lead managers. For all these reasons, one is unable to hold that the effect of the documentation is that there is a sale of the GDRs to ML first and thereafter a resale by the latter to the investing public. For the same reasons, the argument that the commission paid is really in the nature of a sale discount is also not accepted.—*Bomanji Ardeshir Wadia & Ors. vs. Secy. of State* AIR 1929 PC 34 and [CIT vs. UPSIDC](#) (1997) 139 CTR (SC) 267 : (1997) 225 ITR 703 (SC) **distinguished**.

(Paras 28 & 30)

The arrangement between the assessee-company and the managers of the GDR issue cannot be viewed as one for delivery of a "finished package" to the assessee. The assessee-company was seeking to issue the GDRs in the foreign markets. It is for this purpose that it had engaged the services of the managers under the subscription agreement. The subscription agreement contains detailed clauses as to the rights and liabilities of the assessee-company as well as the managers. As rightly pointed out on behalf of the Department, though at the preliminary stages, no break-up was given for the total remuneration payable to the managers and others, ultimately in the subscription agreement, such break-up had been specified. Therefore, it is difficult to view the arrangement as one for delivery of a finished package. It is essentially a service agreement in the sense that the managers had undertaken to render services in connection with GDR issue for which they expected to be remunerated. Thus, it is not possible to accept the "finished package" theory. The payment has been made to the managers only for services rendered by them in connection with the GDR issue.

(Para 33)

The payment in the present case is by the assessee-company which is a resident. As per sub-cl. (b) of s. 9(1)(vii), income by way of fees for technical services payable by a resident of India is deemed to accrue or arise in India. The only exception is where such fees are payable in respect of services utilised in a business carried on by such person outside India or for the purposes of making or earning any income, from any source, outside India. In the present case, the issue of GDRs cannot be considered as a business carried on by the assessee-company outside India. The assessee is not engaged in the business of issuing GDRs. The services rendered by the managers in

connection with the GDR issue, though rendered outside India, were utilised in the assessee's business carried on in India. The GDR issue was for the purpose of the assessee's business in India. The services in connection with the issue were utilised in a business carried on by the assessee in India. Therefore, even though the services were rendered outside India by the managers, sub-cl. (b) of s. 9(1)(vii) is attracted. Since the assessee has no business outside India, it follows that the services were utilised only for the purpose of business carried on in India, thus attracting the statutory provision.

(Paras 38 to 41)

No distinction could be made between the position prior to 9th Nov., 1994 and the position after the said date. Even assuming that the r. 144A GDRs were to be issued only in favour of qualified institutional buyers in USA from whom there is already a firm commitment and consequently there would be no need for underwriting anything with regard to this part of the issue, still the lead managers have to act as underwriters in respect of the other part of the issue where there is no such firm commitment and no qualified institutional buyers. The services rendered by the managers did not come to an end on the entering of the agreements on 9th Nov., 1994. They continued under the agreements entered into on the said date. By the time the subscription agreement was entered into on 9th Nov., 1994, there was already a firm commitment from qualified institutional buyers in USA with regard to the r. 144A GDRs. Therefore, the contention that so far as r. 144A GDRs are concerned there was nothing to underwrite appears to be correct. But the same thing cannot be said of the issue in Europe and other countries outside USA in respect of which there was no such commitment since they were offered to the investing public. Thus the lead managers were under an obligation to underwrite this part of the issue as on the date of the subscription agreement. The resultant position is that there was no underwriting in respect of r. 144A GDRs issued in USA and in respect of the GDRs issued outside USA there was an underwriting. But in respect of both the issues, the other services rendered by the lead managers started much earlier to 9th Nov., 1994.

(Paras 51, 53 & 58)

An underwriter is under a financial commitment to take up the shares in case the issue is not subscribed fully. This undertaking of the risk does not fall to be considered as a managerial, technical or consultancy service. Thus, so far as the issue of GDRs outside USA is concerned the underwriting commission cannot be considered as "managerial, technical or consultancy services" within the meaning of s. 9(1)(vii) r/w Expln 2 thereto. The various types of services rendered by the managers under the arrangement entered into with the assessee-company, both before and after 9th Nov., 1994, may not fall to be considered as "technical" services but they do bear the characteristics of "managerial" or "consultancy" services. In general parlance, managers are appointed by a company to "manage" the issue. This includes a variety of services to be rendered by them in connection with the issue such as the pricing, timing, size and the efforts needed to be undertaken to market the shares/~~de~~bentures/GDRs. Such efforts, in the case of GDRs, include presentations to be made in foreign countries to potential investors about the company, issue of a ~~d~~etailed and informative prospectus, conducting "road shows" and so on and so forth. All these have been undertaken by the managers in the present case. They have also been in constant touch and consultation with the assessee-company with regard to these services. They have also assisted in the compliance with the legal requirements outside India. These may have to be viewed sometimes as "managerial" and sometimes as "consultancy" services in connection with the GDR issue. They cannot be strictly segregated into one or the other type and there may be some overlapping. The arguments that there can be no "managerial services" in respect of an "one-off" transaction, that there should be continuity of services extending to more than one transaction and that such services should have an impact on the "running" of the business cannot be upheld. There are no indications to this effect in the section. The services rendered by the managers are managerial or consultancy services within the meaning of s. 9(1)(vii) r/w Expln. 2 and, therefore, the management commission and the selling commission/concession are income by way of fees for

technical services **deemed** to accrue or arise in India. That part of the underwriting commission which relates to the GDRs issued in USA under r. 144A to qualified institutional buyers is also income by way of fees for technical services **deemed** to arise or accrue in India, and that part of the underwriting commission which relates to the GDRs issued outside USA cannot be considered as income by way of fees for technical services within the meaning of s. 9(1)(vii) r/w Explan. 2 thereto. The assessee-company is not in the business of issuing GDRs and, therefore, cannot claim to fall within the exception mentioned in sub-cl. (b) of s. 9(1)(vii).

(Paras 60 to 62, 64 & 65)

Having regard to the fact that the AO himself did not dispute the applicability of the DTAA with UK, the **Departmental Representative** cannot now be heard to say that it did not apply to the case. The CIT(A) is also not correct in saying that the question of applicability of the DTAA with UK is academic. Further, one cannot possibly infer that the assessee had impliedly admitted [as the CIT (A) says] that the fees paid were taxable in India, merely from the facts that the assessee did not make any application to the AO under s. 195(2) for **determination** of the appropriate proportion of the sum which is chargeable to tax. Even on merits, the objection of the Revenue that the UK agreement does not apply cannot be upheld. The appointment as lead manager is of ML International Ltd. Further, the subscription agreement is, inter alia, with ML International Ltd. and not with ML Asia Pacific Region, Hongkong. The Managers' agreement also refers to ML International Ltd. and the complete London address is given therein. Apparently ML International Ltd. of UK negotiated with the assessee-company through its Asia Pacific Regional office in Hongkong in the preliminary stages. But from that it cannot be said that the assessee utilised the services of the Asia Pacific Regional office of ML, which was located in Hongkong, and, therefore, the UK treaty does not apply.

(Paras 88 & 89)

The **definition** of "technical services" in art. 13.4 of the earlier DTAA agreement with UK which was superseded by the 1993 agreement, was similar to the language employed in s. 9(1)(vii) of the IT Act, 1961 and included "managerial" services. But in the subsequent agreement in 1993, the art. 13.4(c) used different language. It dropped the "managerial" services. The words "making available" in art. 13.4 refers to the stage subsequent to the "making use of" stage. The qualifying word is "which"—the use of this relative pronoun as a conjunction is to **denote** some additional function the "rendering of services" must fulfil. And that is that it should also "make available" technical knowledge, experience, skill, etc. The word "which" occurring in the article after the word "services" and before the words "make available" not only **describes** or **defines** more clearly the antecedent noun ("services") but also gives additional information about the same in the sense that it requires that the services should result in making available to the user technical knowledge, experience, skill, etc. Thus, the normal, plain and grammatical meaning of the language employed is that a mere rendering of services is not roped in unless the person utilising the services is able to make use of the technical knowledge, etc. by himself in his business or for his own benefit and without recourse to the performer of the services in future. The technical knowledge, experience, skill, etc. must remain with the person utilising the services even after the rendering of the services has come to an end. A transmission of the technical knowledge, experience, skills, etc. from the person rendering the services to the person utilising the same is contemplated by the article. Some sort of durability or permanency of the result of the "rendering of services" is envisaged which will remain at the disposal of the person utilising the services. The fruits of the services should remain available to the person utilising the services in some concrete shape such as technical knowledge, experience, skills, etc. The MOU appended to the DTAA with USA and the Singapore DTAA can be looked into as aids to the construction of the UK DTAA. The addition of these words in the Singapore DTAA merely make it explicit what is embedded in the words "make available" appearing in the DTAA with UK and USA. The MOU under the US DTAA and the examples given thereunder, make it clear. The meaning of those words were expressly incorporated in the Singapore agreement by adding the necessary words. For the above reasons, the DTAA with UK applies to the

present case and no technical knowledge, experience, skills, know-how or process, etc. was "made available" to the assessee-company by the non-resident managers to the GDR issue (ML and others) within the meaning of art. 13.4(c) of the DTAA. Therefore, the "management commission" cannot be charged to tax in the hands of ML to whom the same is paid. The assessee-company consequently was under no obligation to **deduct** tax under s. 195. As regards the "underwriting commission", in view of the foregoing discussion, no technical knowledge, etc. was made available to the assessee-company by the rendering of the underwriting services and, therefore, the **definition** in the DTAA is not applicable. For the above reasons, neither the management commission nor the underwriting commission nor even the selling commission/concession would amount to fees for technical services within the meaning of the DTAA with UK and consequently there is no obligation on the part of the assessee-company to **deduct** tax under s. 195. It cannot, therefore, be treated as an "assessee in **default**" under s. 201. Consequently, no interest under s. 201(1A) can be charged.

(Paras 90 to 94, 97, 99, 100, 103 & 130)

The assessee-company must be considered to have "paid" the amounts payable to ML under the subscription agreement by permitting the latter to **deduct** the amounts payable to it and remit only the balance. Sub-s. (1) of s. 195 mentions different modes of payment—cash, cheque, draft "or any other mode". An adjustment of the amount payable to the non-resident or **deduction** thereof by the non-resident from the amounts due to the resident-payer (of the income) would fall to be considered under "any other mode". Such adjustment or **deduction** also is equivalent to actual payment. Commercial transactions very often take place in the aforesaid manner and the provisions of s. 195 cannot be sought to be **defaulted** by contending that an adjustment or **deduction** of the amounts payable to the non-resident cannot be considered as actual payment. The case also falls under the Explanation below s. 195(1) which was inserted w.e.f. 1st June, 1987. The amount has been credited to the GDR issue Suspense account and under the Explanation the credit shall be **deemed** to be credit of the income to the account of ML. Thus, there was a credit also in favour of ML by virtue of the Explanation. Therefore, the contention that s. 195 is not attracted since there is no payment to ML is rejected. There is also a credit in favour of ML.—[J.B. Boda & Co. \(P\) Ltd. vs. CBDT](#) (1997) 137 CTR (SC) 287 : (1997) 223 ITR 271 (SC) **applied**.

(Paras 107 to 109)

Conclusion

Although the services rendered by the lead manager and other managers, all foreign companies, in connection with the GDR issue of the assessee-company are "managerial" or "consultancy" services and fall within the **definition** of "technical services" under s. 9(1)(vii) r/w Explan. 2 thereto said payments do not fall within the **definition** of "fees for technical services" under art. 13.4(c) of the DTAA with UK which is applicable to the facts of the case and were not taxable in India; consequently, assessee-company was not liable to **deduct** tax from the payments and cannot be treated as an assessee in **default** under s. 201 and, therefore, interest under s. 201(1A) could not be charged.

TDS—Payment to non-resident—Order under s. 195(1)—Sec. 195(1) does not contemplate passing of an order thereunder—However, merely because no order under s. 195(1) is contemplated or is necessary it cannot be said that no order can be passed under s. 201(1) in case there is a **default**

Held

Sec. 195(1) merely **declares** the liability to **deduct** tax under certain circumstances and does not contemplate the passing of any order it would appear to be a condition for filing an appeal under s. 248 that the person should have **deducted** and paid the tax. Only in such a case, a right of appeal

is granted, where he could **deny** his liability to make the **deduction**. In the present case, the assessee has not **deducted** nor paid the tax and, therefore, s. 248 is not applicable to it. Another way of looking at the matter is as counsel for the assessee pointed out. According to him, an appeal lies under s. 248 only against an order passed under s. 195(2) which in turn contemplates an application being made by the person paying the same to the non-resident for **determination** by the AO, of the appropriate proportion of the same which is chargeable to tax. There could be a dispute about the proportion **determined** by the AO in which case an appeal lay under s. 248, provided the person **denies** the liability to make the **deduction** as directed by the AO. In either view of the matter, in the present case there is no scope for passing an order under s. 195(1). That, however, does not mean that there would be no order under s. 201 charging interest. Substantively, it is an order under s. 201 charging interest, in case there is a **default** in **deduction** of tax under s. 195. It is in such an order that the AO has to establish that the assessee was liable to **deduct** tax, which he did not, and is, therefore, to be treated as an assessee in **default**. If there is a **default**, the AO is also empowered to charge interest for the same as contemplated by sub-s. (1A) of the section.

(Paras 113 & 114)

Conclusion

Merely because no order under s. 195(1) is contemplated or is necessary it cannot be said that no order can be passed under s. 201(1) in case there is a **default**.

TDS—Payment to non-resident—Income subject to TDS—Sum paid to the non-resident may be either fully or partly chargeable to income-tax—If it is fully chargeable tax has to be **deducted accordingly—If the sum is only partly chargeable (embedded or hidden income), the assessee has to apply under s. 195(2) to the AO for **determination** of the appropriate fraction of the income hidden or embedded therein—In the absence of such an application, the liability extends to the whole payment**

Held

The sum paid to the non-resident may be either fully or partly chargeable to income-tax. If it is fully chargeable (pure income) undoubtedly the tax has to be charged at the appropriate rates on the whole of such sum and **deducted** and paid. If the sum is only partly chargeable (embedded or hidden income), the assessee has to apply under s. 195(2) to the AO for **determination** of the appropriate fraction of the income hidden or embedded therein. The AO in that case will have to pass an order on the assessee's application **determining** the appropriate portion. The assessee has a right of appeal against such order under s. 248 but that right of appeal can be exercised only if the tax is **deducted** and paid. In a case where no such application is filed, then the assessee is liable to **deduct** tax on the footing that the whole sum is chargeable to tax. The assessee in the present case was not liable to **deduct** tax at the appropriate rates applied to the whole of the amount paid to the non-resident managers. The assessee was liable to **deduct** tax only on the appropriate proportion (the hidden or embedded income) of the amounts. But in order to do so, the assessee ought to have applied to the AO under s. 195(2). It did not file any such application. Therefore, the assessee ought to have **deducted** tax on the footing that the whole amount represented "pure income".

(Para 117)

Conclusion

Sum paid to the non-resident may be either fully chargeable or partly chargeable to income-tax and accordingly whole or part amount has to be subjected to TDS under s. 195 accordingly.

TDS—Payment to non-resident—Recovery of tax deductible—Can be made even without the service of a notice of demand—Since there can be no order under s. 195(1), there cannot be a notice of demand under this provision in respect of tax—Once the liability is incurred on failure to deduct tax, no further demand is necessary to recover the tax

Held

Sec. 156 says that when any tax is payable in consequence of an order passed under the Act, the AO shall serve on the assessee a demand notice in the prescribed form specifying the amount payable. The section refers only to tax payable "in consequence of any order passed under the Act". But since the assessee has successfully contended that there can be no order under s. 195(1) obviously there cannot be a notice of demand under this provision in respect of the tax. The order under s. 201(1) is for the purpose of declaring the assessee-company as an "assessee in default". In the case of s. 201 r/w s. 195, it is the failure to deduct the tax that visits the assessee with the liability of an "assessee in default". The liability under s. 195 or s. 201 is at no time ambulatory, but is attracted immediately upon the happening of an event, viz., the failure to deduct tax. There is no further requirement of computation or assessment. Once the liability is incurred, no further demand is necessary to recover the tax. Under the circumstances, the tax can be recovered from the assessee-company.—[Traco Cables Co. Ltd. vs. CIT](#) (1987) 62 CTR (Ker) 174 : (1987) 166 ITR 278 (Ker) **relied on.**

(Para 121)

Conclusion

Recovery of tax deductible under s. 195(1) can be made even without the service of a notice of demand.

Legislation referred to

Section 9(1)(vii), 156, 195, 201, 201(1A), DTAA between India and UK Art. 13.4(c),

Cases referred to

AEG Telefunken vs. CIT (1999) 151 CTR (Kar) 222 : (1998) 231 ITR 129 (Kar)

Bennett Coleman & Co. Ltd. vs. V.P. Damle, Third ITO (1986) 47 CTR (Bom) 342 : (1986) 157 ITR 812 (Bom)

CIT vs. Cooper Engineering Ltd. (1968) 68 ITR 457 (Bom)

CIT vs. Davy Ashmore Indian Ltd. (1991) 190 ITR 626 (Cal)

CIT vs. Dunlop Rubber (1979) 8 CTR (Cal) 110 : (1980) 121 ITR 476 (Cal)

CIT vs. Superintending Engg. Upper Sileru (1985) 46 CTR (AP) 238 : (1985) 152 ITR 753 (AP)

CIT vs. Visakhapatnam Port Trust (1984) 38 CTR (AP) 1 : (1983) 144 ITR 146 (AP)

CWT vs. Arvind Narottam (1988) 72 CTR (SC) 94 : (1988) 173 ITR 479 (SC)

G.V.K. Industries vs. ITO (1997) 228 ITR 564 (AP)

Grindlays Bank Ltd. vs. CIT (1992) 110 CTR (Cal) 164 : (1993) 200 ITR 441 (Cal)

Gwalior Rayon Silk Mills Ltd. vs. CIT (1983) 37 CTR (MP) 351 : (1983) 140 ITR 832 (MP)

Hyundai Heavy Engineering Industries vs. D.C. Pant & Ors. (1994) 120 CTR (Bom) 101 : (1994) 204 ITR 113 (Bom)

M.M. Parikh, ITO vs. Nawanagar Transport & Industries Ltd. (1967) 63 ITR 663 (SC)

Oberoi Hotels vs. CBDT (1998) 146 CTR (SC) 222 : (1998) 231 ITR 148 (SC)

P.C. Ray vs. A.C. Mukherjee, ITO (1959) 36 ITR 365 (Cal)

Steffen, Robertson & Kirsten Consulting Engineers & Scientists, In re (1998) 144 CTR (AAR) 90 : (1998) 230 ITR 206 (AAR)

Circulars referred to

Circular No. 333 dt. 2nd April, 1982

Circular No. 786, dt. 7th Feb., 2000

Counsel appeared

S.E. Dastur, for the Appellant : S.D. Kapila, for the Respondent

Order

R.V. EASWAR, J.M. :

Facts

The assessee in these appeals is Raymond Ltd., a public limited company engaged in the manufacture of suitings, engineers' steel files and rasps and cement in India. In order to muster funds for the purpose of putting BD facilities for the production of cold-rolled steel products including silicon products, the Greenfield Textile project and the normal capital expenditure requirements, the company proposed to issue Global **D**epositary Receipts (GDRs) in the international market. Two types of GDRs were contemplated—(1) International GDRs which were offered to investors outside the United States of America (USA) and India restricted to offshore transactions, and (2) GDRs under r. 144A of the Securities Regulations of the USA, offered in the USA to "qualified institutional buyers" (QIBs). The total number of GDRs issued was 37,68,844. The issue price of each GDR was US \$ 15.92. Each GDR represented 2 shares of the company of the face value of Rs. 10 per share. Approximately US \$58 million were expected to be collected by the issue of the GDRs.

2. On 9th Nov., 1994, certain documentation took place in connection with the issue of GDRs. Firstly, an agreement styled "subscription agreement" was entered into between the assessee-company on the one hand and (1) Merrill Lynch International Ltd. (2) Goldman Sachs (Asia) Ltd. and (3) DSP Financial Consultants Ltd., on the other. Copies of this agreement are placed at pp. 107 to 149 of the paper book filed by the assessee. This agreement provided in **d**etail for the rights and duties of the concerned partners vis-a-vis the GDR issue, warranties, approvals to be obtained, **d**elivery of GDRs, payment, opinions to be obtained, commission payable to the managers of the issue and so on and so forth.

3. Secondly, an agreement styled "managers' agreement" was entered into on 9th Nov., 1994, between Merrill Lynch International Ltd. on the one hand and (1) Goldman Sachs (Asia) Ltd. (2) DSP Financial Consultants Ltd. (3) Banque Paribas (4) Barclays de Zoele Wedd Ltd. (4) Bear, Stearns International Ltd. and (5) Swiss Bank Corporation on the other. Copies of this agreement are placed at pp. 9 to 13 of the paper book No. 1 filed by the Department. This agreement provided for the regulation of the inter se relationship between the managers of the issue.

4. Thirdly, on the same day, an agreement was entered into between the assessee-company and Citibank N.A. which acted as the Depository. This agreement was styled "deposit agreement" and copies of the same are at pp. 14 to 29 of the Department's paper book No. 1. Nothing much in this agreement is important for the purpose of this case.

5. Fourthly, a "deed poll" was entered into by the assessee-company in favour of the prospective purchasers of the GDRs which is placed at pp. 28 and 29 of the Department paper book No. 1. Nothing much in this agreement is important for the purpose of this case.

6. Fifthly, on the same day an "offering circular" was issued, containing details about the assessee-company, investment considerations, market price information, terms and conditions of the issue of the GDRs, the form of the GDR, Government approvals, taxation, financial operations and results and so on and so forth. This is in the nature of a prospectus issued by companies in connection with the issue of shares. The offering circular is placed at pp. 151-301 of the paper book filed by the assessee.

7. Before we proceed further, it may be of some use to know the meanings of certain words used in this case. A GDR (Global Depository Receipt), according to the Compendium on SEBI Capital Issues & Listing authored by Dr. K.R. Chandratre and others, "is an instrument that is in the first instance made in the form of "Receipts" and which is based on underlying ordinary (equity) shares of the issuer company". "Global" means worldwide. "Depository" means a place where something is deposited for safekeeping (such as a bank), usually under a specific depository agreement. In a nut-shell, GDR means any instrument in the form of a depository receipt of certificate created by the overseas depository bank outside India and issued to non-resident investors against the issue of ordinary shares. The GDRs are backed by shares—in the present case, each GDR is backed by two equity shares. The shares are issued in the name of the depository, which is Citibank in the present case. It is the depository who subsequently issues the GDRs. The physical possession of the shares is entrusted to a custodian, who, in the present case, is the ICICI. The custodian is the agent of the depository. Thus, a GDR represents the issuing of a company's shares, but it has a distinct entity and does not figure in the books of the company separately. According to the compendium referred to above, the main advantage of a GDR to the issuer-company is that the company is not exposed to any exchange risk, although it is able to mobilise foreign exchange by way of issue proceeds. The dividend outflow is in rupee terms, but the depository converts this into US dollars and pays them to the ultimate investors. The GDRs are issued in foreign currency, they do not carry any voting right, there is no exchange risk for the issuer as it is issued in US dollars, they are listed at the Luxembourg Stock Exchange and are traded in two other places (e.g., OTC market in London and on the private placement market in USA), and do not have a lock-in-period.

8. Normally, Indian companies issuing GDRs are forced to depend on the services of underwriters and international merchant bankers of repute for marketing the GDRs because such companies may not be well-known outside India. They also require the services of the underwriters and international merchant bankers in order to comply with foreign rules and regulations, conducting "road shows"—making known to the public the activities of the company and the financial results and details about the profitability of the project, etc.—and generally taking efforts to push the sale of GDRs. With this end in view, the assessee-company engaged Merrill Lynch International Ltd., a company incorporated in United Kingdom, as "lead manager" and others such as Goldman Sachs, DSP Financial Consultants Ltd., Barclays, Banque Paribas, etc. as "managers" to the issue. These firms were to be remunerated for their services. The basic question in the present appeals is

whether the assessee-company is liable to **deduct** income-tax from the amounts paid to them for their services under s. 195(1) of the IT Act. The question has various facets to it and they were all argued before us elaborately by both sides and all those facets will be considered.

9. The AO took the view that the assessee-company was liable to **deduct** tax from the payments made to the above firms. He, therefore, passed a **detailed** order under s. 195(1) holding that the amounts were chargeable to tax in India as "fees for technical services" within the meaning of s. 9(1)(vii) of the Act and hence tax ought to have been **deducted**. Since the assessee-company failed to do so, he held the company to be an assessee "in **default**". He also passed an order separately under s. 201(1) and (1A) charging interest. The amount of tax sought to be recovered from the assessee-company is Rs. 1,93,73,049 and the amount of interest is Rs. 1,54,98,439.

10. The assessee filed appeals against both the orders to the CIT(A). Various contentions, both of fact and law, were taken before him on behalf of the assessee which we shall presently notice. Suffice here to say that the CIT(A) agreed with the AO that the assessee-company was liable to **deduct** the tax from the commission paid to Merrill Lynch and that not having **deducted** the same, it was an assessee in **default**. The CIT(A) also upheld the levy of interest under s. 201(1A) except that he restored the calculation part thereof to the AO, in the absence of the **details** relating thereto in the order passed by the AO. The CIT(A) also **dealt** with various other issues that arose in connection with the appeals and these will be noticed at the appropriate juncture. The assessee has filed two appeals, one challenging the **decision** of the CIT(A) with regard to the assessee's liability to **deduct** tax under s. 195(1) and the other challenging his **decision** regarding the liability to pay interest under s. 201(1)/(1A). This is how two appeals are before us.

Issues

11. The various issues that arise in the appeals are as under :

(a) Is the selling commission, underwriting commission and management commission paid by the assessee to Merrill Lynch "fees for technical services" and chargeable as income in India with reference to the provisions of s. 9(1)(vii) of the IT Act and the provisions of the Double Tax Agreement with UK ? In this connection, is the assessee correct in contending that there was first a sale of the GDRs to Merrill Lynch who in turn sold them to the investors ? Again, is the assessee correct in contending that the arrangement under the documentation is one under which the assessee obtained a finished package by which for a payment to the underwriters/managers, they would successfully put through the GDR issue ?

(b) If both the purchase and resale theory and the finished package theory are not acceptable, can the services rendered by the lead manager and others in connection with the GDR issue be called "management, technical or consultancy services" within the meaning of s. 9(1)(vii) of the Act ?

(c) Assuming that the services fall within the abovementioned section, can they be considered as "technical services" within the meaning of the relevant article in the DTAA with UK ?

(d) Was there a payment to or credit in favour of Merrill Lynch in order to attract s. 195(1) ?

(e) Can an order be passed under s. 195(1) and if not, can an order be passed under s. 201 ?

(f) Can the tax be recovered from the assessee-company in the absence of a notice of **demand** ?

(g) Was the levy of interest under s. 201(1A) justified, even though the assessee acted bona fide and on the advice of its solicitors in not **deducting** tax ?

(h) Were the expenses reimbursed by the assessee chargeable to tax in India ?

12. The above are certain broad issues which arise in these appeals and they are **dealt** with in the coming paragraphs. Certain incidental issues have also been discussed for the sake of completeness and in **deference** to the arguments advanced before us, though some of them would appear to be academic.

13. Before we discuss the issues, we may furnish the relevant figures of commission paid and expenses reimbursed by the assessee. The **details** are given in the additional grounds dt. 8th June, 2000. They are as under :

	Per GDR	%	US \$	Rs.
(i) Management commission	0.0938 US \$	19.64	3,71,196	1,16,55,709
(ii) Underwriting commission	0.0938 US \$	19.64	3,71,196	1,16,55,709
(iii) Selling commission	0.2900 US \$	60.72	11,47,608	3,50,35,370
		100.00	18,90,000	5,93,46,788
(iv) Legal fees reimbursed			2,50,000	78,50,105
			21,40,000	6,71,96,293
(v) Road Show expenses reimbursed			1,39,514	44,15,632
			22,79,514	7,16,12,525
(vi) Printing charges paid directly to M/s Corporate Printing Co. International Ltd.			1,40,427	44,54,669
(vii) Video Film charges paid to India party viz., Macademy, Bombay				14,25,000
		Total		7,74,92,194

14. The matter was argued very elaborately before us by both the sides. On a consideration of the rival contentions, the facts of the case and the orders of the IT authorities, we proceed to give our findings on the various issues arising in these appeals in the succeeding paragraphs.

The "resale or subscription" theory :

15. Put in its simplest form, the argument was that the assessee-company just sold the GDRs to the managers or that the agreement was that they should subscribe for them and, therefore, there is no question of their rendering any kind of services to the assessee-company. They in turn sold the GDRs to the investors. Consequently, the assessee was under no liability to **deduct** tax.

16. The CIT(A) has adverted to this point in para 18.4 of his order. The argument before him was that the assessee had no inter-face with the investors in the GDRs except for the road shows, that the amount retained by the managers represented the discount and the balance remitted by them represented the sale price of the GDRs and thus nothing is taxable in their hands and consequently the assessee was not responsible for **deducting** any tax under s. 195(1) as there is no income element.

17. This argument has been met by the CIT(A) by saying that though there is a "sprinkling of suggestions" in the agreement with the managers to suggest that the arrangement amounted to a sale of GDRs to them, in truth it is not so. The reasons he gave are :

(a) the RBI and Ministry of Finance have approved the agreement on the basis that Merrill Lynch would be the lead managers of the issue and not the purchaser of the GDRs;

(b) that for their services the managers were to be paid 3 per cent of the sale proceeds as selling commission and were also to be reimbursed certain expenses which is inconsistent with the position that they are purchasers of the GDRs;

(c) they (the managers) have rendered certain services in connection with the issue which are quite unnecessary if they were to be the purchasers;

(d) the assessee and not the managers who are shown as sellers, the shares are transferred direct to the **de**positary, there is no price differential, etc. and hence they cannot be called the purchasers of the GDRs;

(e) that in a straight sale there is no need for the managers to render so many services;

(f) that the assessee had incurred expenses such as issue of prospectus, road shows, stationary, payment of **de**positary fees, etc. which would not be the case had the transaction been one of outright sales;

(g) that there is nothing to be gained by saying that the assessee-company does not know the ultimate buyers of the GDRs which is the case in all issues of shares/GDRs; and

(h) that the price has been fixed by the assessee and not the lead managers and the GDRs were not sold under their banner.

18. Before us it was contended by Mr. Dastur, the learned counsel for the assessee, that the "primary thrust" of the agreement was that it would be a sale of the GDRs to the managers or that they would subscribe to them and not that they would merely render certain services in connection with the issue. Reliance was placed on certain portions of p. 2265 of the "Compendium on SEBI Capital Issues and Listing" by Dr. K.R. Chandratre & Ors. 1996 Ed., Vol. 2 to contend that the underwriters would "purchase and resell" the GDRs. Reliance was also placed on the "offering circular" issued by the assessee-company on 9th Nov., 1994 (pp. 151-301 of the assessee's paper book @ pp. 226-227) wherein there is reference to r. 144A of the Securities Act of the USA. On the basis of this rule, it was submitted that under the concept of "firm underwriting", recognised by the rule, there is a sale of the GDRs first to the managers/underwriters who in turn sell them to the actual investors.

19. Another facet of the argument of Mr. Dastur was that this is not a case of a subscription "simpliciter" where the buyer retains the shares. It was pointed out that the managers are interested in disgorging the shares and they are merely being compensated by the assessee-company for the costs incurred. The "selling concession" given to them as per the agreement is only a discount from the sale price. The underwriting commission is paid for guaranteeing that the entire issue of GDRs will be subscribed. As held by the Supreme Court in the case of CIT vs. UPSIDC (1997) 139 CTR (SC) 267 : (1997) 225 ITR 703 (SC), the underwriting commission will only go to reduce the cost of the shares in the hands of the managers.

20. Relying on cls. 7(g) and (i) ("conditions precedent") of the "subscription agreement" (pp. 136 and 139 of the assessee's paper book) it was further contended that the liability of the managers was to remit the "net subscription monies" which meant that the GDRs were sold to them and that the assessee-company would look to the managers for the sale proceeds. It was said that if the assessee were to file a suit in case an investor fails to pay, that would have to be against the manager in his capacity as purchaser and not against the investor.

21. Reliance was also placed by Mr. Dastur on s. 2(11) of the US Securities Act which **de**finies an "underwriter" as a person who has "purchased" the shares from the issuer.

22. The contention urged by Mr. Kapila on behalf of the Revenue was firstly that r. 144A does not concern itself with any underwriting at all, that whatever has been stated about the rule is contained only in a private circulatory offer, that it is not a case of sale by the issuer (assessee) to the managers and then by the managers to others, that as per cl. 8(f) of the "subscription agreement" dt. 9th Nov., 1994, between the assessee-company, the **depository** (Citibank N.A.) and the custodian (ICICI) the company cannot make a sale of GDRs to the manager and, therefore, the question of the managers making a further sale of the GDRs simply does not arise. From the final offering circular (p. 151-301 of the assessee's paper book) it was contended that the lead managers (Merrill Lynch) had agreed to purchase the GDRs only if there is **default** by the "purchasers-in-equity" i.e., those who had given firm commitment prior to 9th Nov., 1994, to take the GDRs and from this it cannot be said that they (lead managers) are the purchasers and, therefore, there is no tax implication in the transaction subjecting the assessee-company to **deduct** tax. It was pointed out that the issue of GDRs was only in favour of prospective investors and not the lead managers or other managers so that they can be stated to have "purchased" them. It was then contended by Mr. Kapila that the "subscription agreement" was signed by all the three—Merrill Lynch, Goldman Sachs and DSP—and that it is not as if only Merrill Lynch has signed it and has entered into separate agreements with the other two. There was thus no sale of the GDRs to Merrill Lynch or the other managers. It was also pointed out that the money was paid by the investors (who had committed themselves prior to 9th Nov., 1994) and not by Merrill Lynch or the other managers which showed that there could have been no sale of the GDRs to the managers. A question was posed as to why all this elaborate exercise should have been gone through if the assessee had actually sold the GDRs to the managers. Our attention was drawn by Mr. Kapila to cl. 3(1) of the "managers' agreement" dt. 9th Nov., 1994. It was pointed out that the sub-clause did not provide for any penalty or damages for **defaulting** managers which would be meaningless if the GDRs are considered sold by the assessee-company. It was further pointed out that by 9th Nov., 1994, the date of the agreement, firm commitments from investors already existed and, therefore, the question of any sale of the GDRs to the managers could not possibly have been in contemplation. The presence of DSP Financial Consultants, an Indian company, it was finally argued, 'exploded' the "purchase and resale" theory. DSP was registered as a merchant banker of category-I under regn. 3(2)(a)(i) of Chapter-II of the SEBI Rules, 1992 (Securities and Exchange Board of India), which made it an Indian merchant banker who cannot buy or sell GDRs. Our attention was drawn in particular to regn. 13, 20, 22 and 26, r/w Sch. III of the Rules. The contention was that since an Indian merchant banker, who is prohibited from buying and selling GDRs, is party to the subscription agreement, it could not have been intended by the parties thereto that there would be a sale of the GDRs first to the lead manager and other managers and thereafter by them to the investing public. All these facts, it was submitted, were inconsistent with the "resale theory".

23. The above arguments of Mr. Kapila for the Revenue were countered by Mr. Dastur in his reply on behalf of the assessee thus. He pointed out that the earlier negotiations between the parties should be ignored and that the contract as finally entered into alone should be looked into to ascertain the intention of the parties. A formal contract, it was said, will supersede the terms of the letter dt. 26th Sept., 1994, written to the assessee-company by Merrill Lynch of Asia-Pacific Region and on which heavy reliance was placed by the Revenue. It was also said that the last paragraph of the letter (p. 35 of the **Department's** paper book No. 1) shows that there will be a formal contract which will reflect the final parameters of the GDR issue. Mr. Dastur's refrain was "Do not look into this letter as **determinative** of the issue whether it is a purchase/resale arrangement". Reliance was placed by him on the judgment of the Privy Council in Bomanji Ardeshir Wadia & Ors. vs. Secy. of State AIR 1929 PC 34 where it was held that the correspondence cannot be looked into if there is a formal contract. In support of this argument, our attention was drawn to the following documentation :

(a) Recital (B) of the preamble to the "subscription agreement" wherein it is provided that so far as the assessee is concerned Merrill Lynch, Golden Sachs and DSP are the purchasing parties, jointly and severally (p. 108 of the assessee's paper book);

(b) Recital in cl. 1(a) of the said agreement to the effect that the managers jointly and severally agree to purchase the initial and optional GDRs (p. 110 of the same paper book);

(c) Recital in cl. 2(d) to the same effect (p. 112 of the same paper book);

(d) Clause 4 ("commissions") at p. 128 of the paper book where there is a reference to the "commitment" by the managers to subscribe for the GDRs and pay @ \$ 15.92 per GDR;

(e) Clause 6 ("closing, **d**elivery and payment") at p. 131 of the paper book which refers to payment for the GDRs being made by Merrill Lynch on behalf of the managers;

(f) Clause 8(e) ("restrictions") where there is reference to "resale" and "resold" by Merrill Lynch of the GDRs.

The contention of the Revenue based on r. 144A was sought to be met by pointing out that the object of the rule is to protect the QIBs and that they would be familiar only with names such as Merrill Lynch, who is **d**escribed as "seller" and not with the assessee-company who is **d**escribed as the "issuer". It was thus contended that even r. 144A sales (to QIBs) are only resales. Mr. Dastur also pointed out that r. 144A made a distinction between an "issuer" and "seller" and treated the sales under the rule, of securities, as "resales". The assessee was the "issuer" and the managers (Merrill Lynch, etc.) were the "sellers", which supported the "resale" theory.

24. Our attention was also drawn in the reply by Mr. Dastur to the reference to the lead manager and other managers agreeing "jointly and severally, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the initial offering price..." appearing in the offering circular (at p. 251 of the assessee's paper book) under the heading "subscription and sale" and it was contended that this also supported the sale or subscription theory. It was further pointed out that r. 144A allows it and, therefore, the resale theory is not a mere facade to cover up the real position in law. It was said that even the "managers' agreement" (page. 9 of the **D**epartment's paper book), to which the assessee-company was not party, provided that the managers inter se agreed that they will purchase the GDRs though so far as the assessee is concerned the offer would be made only to Merrill Lynch, the lead manager. This reinforced the resale theory.

25. Attention was also drawn to the opinion of the UK solicitors (p. 72 of the **D**epartment's paper book). In the letter dt. 23rd Nov., 1994, written to Citibank N.A. which says that the arrangement is a "reoffer and resale" of the GDRs.

26. It was then contended that the appointment of DSP, which is approved by the Government and the RBI (copies of approval filed), does not in any way affect the legality or propriety of the "resale" theory.

27. It was finally contended that the arguments put forward on behalf of the **D**epartment does not take into account the rule laid down by the Supreme Court in CWT vs. Arvind Narottam (1988) 72 CTR (SC) 94 : (1988) 173 ITR 479 (SC) where it has been held that effect of the entire documentation must be considered in understanding a transaction.

28. Having had the benefit of the rival contentions with regard to the "purchase and resale" theory, we are unable to give effect to the same. At the grossest level and shorn of all legal niceties, it appears to us to be somewhat unusual to view the arrangement as one of purchase and resale by the lead and other managers to the issue of GDRs. A simple issue of shares in India, so far as we know, is not seen as a purchase and resale thereof by the underwriters or brokers. An underwriter is one whose business it is to guarantee that the issue would be subscribed fully or to the extent of his share and the question of his buying the shares would come up only if the issue is not subscribed fully or to the extent of his share which he has underwritten. It is only then that he is

liable to acquire the shares remaining unsubscribed which he may hold on to or disgorge depending on market conditions. In such a situation it is difficult to hold, merely because of the underwriter's obligation to buy the shares under a certain contingency, that the arrangement with him is one for sale of shares to him and resale by him to the investors. But the case put forward before us on behalf of the assessee was that what we are concerned is not a simple share issue in India but an issue of GDRs of huge magnitude where legal niceties do matter. It was also contended on the strength of high authority (the judgment of the Privy Council cited supra) that the firm commitments obtained prior to 9th Nov., 1994, should be ignored and the contract as finally concluded alone should be looked into. But we are not sure whether the principle laid down in the above authority can be extended to commercial arrangements of the type with which we are concerned in this case. That was a case of a Government grant and it was held that what mattered ultimately were the terms of the grant itself and not the "antecedent communings". But herein we are concerned with a commercial or financial transaction where an Indian company desires to mop up the savings of people outside India by issue of financial instruments that have gained currency in recent times. To such a situation we do not feel inclined to apply the Privy Council ruling and make the flow of events water-tight and isolated from each other. We would prefer to look at the events on a broader canvass and so viewed we find it difficult to hold that though there were firm commitments prior to 9th Nov., 1994, for the purchase of the GDRs from QIBs still it must be held, on the strength of certain documentation between the parties where the words "resale" (with its grammatical variations) or "reoffer" are coined that there is a sale first to the managers and then by them to the investors. That apart, we are in general agreement with the reasons given by the CIT(A), which were also canvassed before us by the Revenue, in support of his conclusion that the arrangement is not one of "purchase and resale" of the GDRs by the managers. We also see force in the contention raised by the Department that if the GDRs are to be considered as having been purchased by the managers and sold by them to the investors the whole exercise of the managers rendering a variety of services to the assessee becomes meaningless. The possibility that the potential investors may not have heard the name of the Indian company and would, therefore, hesitate to invest in its GDRs and it is only because the well-known firms of Merrill Lynch, Goldman Sachs and DSP, etc. are involved that they would invest in them does not lead to the result that those managers had purchased the GDRs for resale. We venture to say that it would be unreasonable to imagine a situation where though potential investors would hesitate to buy the assessee-company's GDRs, but the managers, who are experts in the line, would take the plunge and purchase them in the hope of reselling them. That perhaps is a risk which would be bad for their business. We, therefore, think, taking an overall—perhaps a robust—view of the matter and without attaching undue importance to the language used in the documentation to which our attention was drawn on behalf of the assessee that the better view to take in this case is to hold that the "purchase and resale or subscription" theory cannot possibly be given effect to.

29. The judgment of the Supreme Court in UPSIDC's case (supra) is limited to the question whether an underwriter can adjust the underwriting commission received by him against the cost of those shares which he was obliged to buy, they having remained unsubscribed for. We are, with respect, unable to read anything therein which would support the "resale" theory.

30. As for the effect of the entire documentation which one is certainly bound to consider in understanding a particular transaction—the rule laid down in Arvind Narottam (supra)—we are satisfied, that even taking into account all the relevant documents, it is difficult to accept the "resale or subscription" theory. It is true that the language employed in the documentation gives the impression, as the CIT(A) says, that there is a purchase of or subscription to the GDRs by the lead managers (Merrill Lynch) but we would prefer to be guided by the substance of the matter rather than the form in which it is put through. As rightly pointed out on behalf of the Revenue, if it was a case of a simple sale of the GDRs to Merrill Lynch and thereafter a sale by them to the investing public, there is no need for such meticulous documentation defining the rights and duties of the concerned parties with regard to the services to be rendered by each of them in connection with the GDRs. There was also no need for the assessee to participate in the road shows. There was perhaps not even the need to issue an offering circular, which is in the nature of a prospectus

giving complete details about the assessee-company. There was no question of the assessee paying 3 per cent or 4 per cent of the sale proceeds as selling commission and reimbursing certain expenses to the lead managers. For all these reasons, we are unable to hold that the effect of the documentation is that there is a sale of the GDRs to Merrill Lynch first and thereafter a resale by the latter to the investing public. For the same reasons, the argument that the commission paid is really in the nature of a sale discount is also not accepted.

The "finished package" theory

31. It was contended on behalf of the assessee that if the resale or subscription theory is not found acceptable, the entire arrangement between the assessee-company and the managers of the GDR issue should be considered as an arrangement under which the assessee obtains a "finished package". By "finished package", what is meant is this. The assessee is liable to pay a sum "not exceeding 4 per cent of the issue proceeds towards selling commission, underwriting commission, management fees and other out-of-pocket expenses under s. 9(1)(a) of FERA". As per the application made to the Exchange Control Department of the Reserve Bank of India (RBI) (application dt. 15th Sept., 1994, copy placed at pp. 77 and 78 of the Department's paper book), it is pointed out that no bifurcation of the payment between the four components—selling commission, underwriting commission, management fees and other out-of-pocket expenses—was in the contemplation of the assessee when the approval of the RBI was sought. The RBI also approved the payment (p. 68 of the Department's paper book). However, the approval was for making payment of actuals but not exceeding 4 per cent of the issue proceeds. The RBI, however, stated that the payment would include management fees, underwriting and selling commissions, depositary fees, legal expenses and other out-of-pocket expenses, etc. Though certain items of expenses have been additionally approved by the RBI, the total payment was not to exceed 4 per cent of the issue proceeds. The payment was also approved by the Ministry of Finance (p. 73 of the Department's paper book), which was the preliminary approval. The final approval was given on 12th Sept., 1994, which approved the payment of selling commission, underwriting commission, management and other out-of-pocket expenses upto 4 per cent of the issue size (p. 75 of the Department's paper book). Thus, at all the preliminary stages, till the Ministry of Finance and the RBI gave their final approvals, the payment was conceived as a package with no break-up thereof mentioned. It may only in cl. (4) of the subscription agreement dt. 9th Nov., 1994 that the break-up of the payment was specifically mentioned. In this background, the contention is that what is paid by the assessee to the managers is just a remuneration for a "finished package" viz., that the GDR issue should be put through by the managers. The assessee-company, it was said, was not interested in the technical skill of Merrill Lynch or the other managers. It was interested only in ensuring the success of the issue and so long as the managers were able to inform the assessee that the issue has been successfully put through, the assessee-company was not interested in the type of technical services which the managers might have rendered. In other words, it was said that the assessee-company and the managers have in substance agreed that the latter would ensure that the GDR issue was successfully marketed. In this view of the matter, it cannot be said that there was a rendering of any managerial, technical or consultancy services within the meaning of Explan. (2) to s. 9(1)(vii) of the IT Act. It was also added that even assuming that the entire GDR issue was underwritten by the managers, underwriting was only a financial activity or service. The assessee was really not interested in knowing under what category the type of services rendered by the managers would fall so long as the GDR was successfully put through. Thus, the deal between the assessee-company and the managers was that the assessee would look upon the managers to ensure that the GDR issue was successfully marketed without bothering about what type of services would they be rendering.

32. The argument of the Department is that the break-up of the remuneration or the fees payable to the managers is immaterial. Merely because the break-up is not given in the preliminary stages of the transaction, it does not follow that what is paid is not for various types of services rendered by the managers. It was emphasized that ultimately in the subscription agreement, the break-up was given [cl. (iv)] and this itself weakened the assessee's stand. It was contended that in

substance, the remuneration represented fees for various managerial and consultancy services.

33. On a careful consideration of the matter, we are satisfied that the arrangement between the assessee-company and the managers of the GDR issue cannot be viewed as one for **delivery** of a "finished package" to the assessee. The assessee-company was seeking to issue the GDRs in the foreign markets. It is for this purpose that it had engaged the services of the managers under the subscription agreement. The subscription arrangement contains **detailed** clauses as to the rights and liabilities of the assessee-company as well as the managers. It is not as if the assessee-company simply entrusted the issue of GDRs to the managers and told them that it was their look out to successfully market the same and bring to the assessee the news that the issue is a success or, in other words, that the "finished package" has been **delivered**. If that were to do so, there would not have been a need for such elaborate and carefully worded documentation. As rightly pointed out on behalf of the **Department**, though at the preliminary stages, no break-up was given for the total remuneration payable to the managers and others, ultimately in the subscription agreement, such break-up had been specified. Therefore, we find it difficult to view the arrangement as one for **delivery** of a finished package. It is essentially a service agreement in the sense that the managers had undertaken to render services in connection with GDR issue for which they expected to be remunerated. The assessee was very much concerned or interested in the nature and type of services that they would render. The managers are leading companies, internationally known for the type of services they render in connection with large issues in the capital markets and the assessee has chosen them apparently with great care and on the basis of their reputation. The reputation arises because of the type and nature of the services undertaken to be rendered by them. Thus, it is not possible to accept the "finished package" theory. In our considered opinion, the payment has been made to the managers only for services rendered by them in connection with the GDR issue.

Applicability of s. 9(1)(vii)

34. We may recall that the first two limbs of the arguments of Mr. Dastur, the learned counsel for the assessee were based on the "resale" theory and the "finished package" theory. The attempt was to show that if either of the two theories is accepted, then it would mean that what was paid to the managers would not partake the character of income in their hands. In the case of the resale theory, there would have been no question of the assessee paying any income to the managers as the income would have been made or generated by the managers themselves by buying the GDRs from the assessee and selling them in Europe and USA for a profit. In the case of the "finished package" theory, the assessee would be paying for something which it has acquired or bought as a package and whatever has been paid cannot be considered entirely as income in the hands of the managers and perhaps, only a portion thereof may be considered as income, if at all. In other words, the amount paid by the assessee-company would constitute sale price of the "finished package" in the hands of the managers and just as in the case of all sales, the entire amount cannot be considered as profits or income, but only the income element embedded therein. We have already found ourselves unable to accept either of these theories. Therefore, we may proceed to examine the next argument of Mr. Dastur, which was regarding the applicability of s. 9(1)(vii) of the IT Act. The applicability of the section was sought to be challenged on various grounds which we will **deal** with hereunder :

(A) All underwriting activities took place outside India :

35. It is necessary at this stage to reproduce s. 9(1)(vii) of the IT Act :

"9. (1) The following incomes shall be **deemed** to accrue or arise in India —

.....

(vii) Income by way of fees for technical services payable by—

(a) the Government; or

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

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

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

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

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

36. The contention of Mr. Dastur was that since all underwriting activities took place outside India, the aforesaid statutory provision is not attracted. This was controverted by Mr. Kapila on behalf of the **D**epartment, by contending that the services were rendered in India, because the primary activity in connection with the issue of GDRs was the issue of shares which was in India and all other activities, though rendered abroad, were merely supplementaries. It was thus contended by him that the provisions are attracted.

37. We have to notice, at this juncture, a point made by the CIT(A) in para 18.2 of his order. In this paragraph, he has referred to the argument of the assessee that since most of the services were rendered outside India, the remuneration paid for them is not taxable in India. He has held that the argument "does not have any legal support of the provisions of Expln. (2) to s. 9(1)(vii)". He has further held that "the statutory test for **d**etermining the place of accrual is not the place where the services for which the payments were made were rendered but the place where those services were utilised." Having so held, he proceeded to hold further that the fees paid were for services utilised by the assessee in a business which was being carried on by it in India and, therefore, irrespective of the place where they were rendered, the amounts paid to them should be **d**eemed to accrue or arise in India. The CIT(A) has noted that the section does not use the expression "fees for services rendered in India" but has advisedly used the words "fees for services utilised in India", the two expressions having different connotations. He has relied on the judgment of the Authority for Advance Ruling in the case of Steffen, Robertson and Kirsten Consulting Engineers & Scientist, In re (1998) 144 CTR (AAR) 90 : (1998) 230 ITR 206 (AAR).

38. In our view, the conclusion of the CIT(A) is correct. Even if the services are rendered outside India, it is irrelevant for the purposes of s. 9(1)(vii). The place where the services are utilised is relevant. The thrust of the provision is the "source rule"—the source of payment. The payment in the present case is by the assessee-company which is a resident. As per sub-cl. (b) of s. 9(1)(vii), income by way of fees for technical services payable by a resident of India is **d**eemed to accrue or arise in India. The only exception is where such fees are payable in respect of services utilised in a business carried on by such person outside India or for the purposes of making or earning any income, from any source, outside India. In the present case, the issue of GDRs cannot be

considered as a business carried on by the assessee-company outside India. The assessee is not engaged in the business of issuing GDRs. The services rendered by the managers in connection with the GDR issue, though rendered outside India, were utilised in the assessee's business carried on in India. The GDR issue was for the purpose of the assessee's business in India. The services in connection with the issue were utilised in a business carried on by the assessee in India. Therefore, even though the services were rendered outside India by the managers, sub-cl. (b) of s. 9(1)(vii) is attracted.

39. A contention was raised before us that the assessee did not utilise any services of the managers "in India". According to the section, all income by way of fees for technical services payable by a person who is resident in India is **deemed** to accrue or arise in India. The only exception is where such fees are payable "in respect of services utilised in a business or profession carried on by such person outside India". It is not necessary for the purpose of attracting the section that the services should be utilised "in India". There is a distinction between services utilised "in India" and services utilised "in a business carried on in India". No doubt, the services of the managers of the GDR issue have been rendered outside India, but they have been utilised for the purpose of the assessee's business, which is carried on in India. Since the assessee has no business outside India, it follows that the services were utilised only for the purpose of business carried on in India, thus attracting the statutory provision.

40. The argument on behalf of the **Department** that the services were rendered only in India because the primary activity is of issue of shares, is too broad to be accepted. The services were actually rendered abroad and not in India. However, the argument need not be considered further because of our view that the place of rendering of the services is not important for the purpose of the provision.

41. For the above reasons, we agree with the CIT(A) and reject the contention on behalf of the assessee that since all the underwriting activities took place outside, s. 9(1)(vii)(b) is not attracted.

(B) Are the services "managerial, technical or consultancy services" under s. 9(1)(vii)(b) r/w Expln. (2) ?

42. Having held that the services rendered by the managers in connection with the GDR issue were utilised in a business carried on by the assessee in India, we shall now proceed to a consideration of the main contention urged on behalf of the **Department**, both in the orders of the **Departmental** authorities and in the course of the arguments before us, that the services, whatever they are, rendered by the managers must be considered as managerial, technical or consultancy services and, therefore, the fees payable therefor must be **deemed** to arise or accrue in India, attracting the liability to **deduct** tax under s. 195 of the Act. This is one of the most important questions to be **decided** in the present case.

43. We may now advert to the various contentions raised before us in this contention. Mr. Dastur, the learned counsel for the assessee, stated that the underwriting activity is by no means equivalent to the rendering of managerial, technical or consultancy services, since underwriting activity is nothing other than undertaking a risk or a financial commitment and cannot be considered to be a service at all. Adverting to para 18.5 of the order of the CIT(A), he contended that this important issue, which forms the bedrock of the **Department's** case, has been rather summarily disposed of by the CIT(A). He criticised the view taken by the CIT(A) on the basis of the judgment in G.V.K. Industries vs. ITO (1997) 228 ITR 564 (AP) to the effect that advice given to procure loans to strengthen the finances would be a technical or a consultancy service. He equally criticised the conclusion of the CIT(A) based on Oberoi Hotels vs. CBDT (1998) 146 CTR (SC) 222 : (1998) 231 ITR 148 (SC) that the services rendered by the lead managers can be categorised as nothing but technical. The reference by the CIT(A) to the **definition** of the word "technician" appearing in s. 80RRA(2)(c) of the IT Act to mean a person having a specialised knowledge and experience in accountancy was contended to be irrelevant for the purpose of ascertaining whether

the services by the managers in the present case amounted to managerial, technical or consultancy services. According to Mr. Dastur, giving or grant of a loan does not involve the idea of any services being rendered by the lender which are in the nature of managerial, technical or consultancy services and, therefore, any advice given in connection with the procurement of a loan cannot also be a managerial, technical or consultancy service. By issuing GDRs the assessee was actually mobilising resources for the purpose of its business in India and any advice given by the managers as to how to go about the GDR issue, cannot be equated to the rendering of managerial, technical or consultancy services.

44. Coming to the specifics, Mr. Dastur on behalf of the assessee pointed out that cl. (4) of the subscription agreement dt. 9th Nov., 1994 (p. 128 of the assessee's paper book), provided for the payment of (i) management commission, (ii) underwriting commission, and (iii) selling concession. His contention was that items (ii) and (iii) i.e., underwriting commission and selling concession certainly do not come within s. 9(1)(vii). As regards item No. (i) i.e., management commission, Mr. Dastur raised the following four points :

(a) the service rendered by the managers was not a "managerial" service in the general sense of the term or in the sense in which it should be understood because of the fact that the managers also undertook the risk of underwriting the issue. It was pointed out that it cannot be postulated that a person who himself undertakes a risk in a particular venture and thus holds a stake in the result also performs a managerial function. Mr. Dastur gave the example of a person employed to "manage" the assessee's computers department. Such a person would fall, according to him, within the Expln. 2 as a person rendering managerial services, but an underwriter would not fall within the Explanation since he undertakes a risk.

(b) Managerial services cover a larger field than one particular activity. A person cannot be said to render managerial services if it is limited to a "one-off" transaction. It is implied in the very nature of managerial services that there would be some continuity in the sense that the rendering of the services would cover a series of transactions or a series of projects or steps undertaken by the person engaging such services. In the present case, there is only a single GDR issue and, therefore, the managers could not be considered as having rendered managerial services as there is no continuity.

(c) If the management of the issue is viewed, as it should be, as just a part of the larger activity which is the underwriting activity, or is merely incidental thereto, then for the purposes of s. 9(1)(vii), it must be taken that the fees are paid only for the underwriting activity which is outside the purview of the Explanation.

(d) The services rendered by the managers of the GDR issue, in order to be characterised as "managerial services", should have an impact on the running of the business of the assessee and it is not sufficient [to attract s. 9(1)(vii)] if the assessee ultimately gains by the result of such services. The example given was that of fabrication of machinery according to the assessee's specifications. In such a case, the assessee, it was said, does not directly benefit from nor uses the services involved in the fabrication, though the ultimate product viz., the plant or machinery so fabricated, is acquired or purchased by the assessee.

45. As regards the judgment of the Supreme Court in the case of Oberoi Hotels (supra) relied upon by the CIT(A), the argument of Mr. Dastur was that it is distinguishable on facts in the sense that the assessee in that case was rendering all types of services and was thus virtually managing the whole show which is not the case here. It was said that the decision must be "read in the context". Our attention was drawn to the observations of the Court in pp. 171 to 173 of the report (231 ITR) to the effect that the term "technical services" appearing in s. 80-O of the Act included "professional services", a controversy which, according to Mr. Dastur, does not arise in the case before us.

46. The judgment of the Supreme Court in the case of GVK Industries (supra) relied on by the Department was also sought to be distinguished on facts. It was claimed that in that case advice was given as to how a loan could be obtained and it was held that such advice amounted to rendering of "technical services". In the present case, it was said, the assessee did not utilise any advice given by the non-resident company (the managers). With reference to the observations of the Court at p. 582 (of 228 ITR) on which reliance was placed by the Department, it was stated before us by Mr. Dastur that in the present case those observations do not apply because Merrill Lynch has to take the assessee-company on the road and not merely to provide it with a map (to reach the destination) and that this would amount to a "business work" and not the rendering of technical services as defined in Expln. 2.

47. We may now notice the contentions of the Department put forth on its behalf by Mr. Kapila. But before we proceed to do so, it is necessary to notice some of the preliminary but important contentions, put forth by him with considerable vehemence. According to him, a distinction should be made in the present case between the pre-9th Nov., 1994/position and post-9th Nov., 1994 position—what he would put as B.C. and A.D. In his own words, the "services rendered by the managers in the period prior to 9th Nov., 1994/have to be assessed and evaluated only in terms of offer letter dt. 26th Sept., 1994/which became a contract on 23rd Oct., 1994, duly signed by the assessee". He drew our attention to pp. 290-297 of the Department's paper book and pointed out that the services rendered by the managers prior to 9th Nov., 1994 in connection with the size of the issue, price and the allocation were listed therein. He also pointed out that though the services in this behalf (size, price and allocation) were to be rendered by the managers, the ultimate decision with regard to each of them was that of the assessee-company, which was the "issuer". The services rendered by the lead managers to the assessee prior to 9th Nov., 1994, in connection with the GDR issue, in the words of Mr. Kapila, were :

- (a) issuing preliminary offering circular (26th Oct., 1994);
- (b) carrying out road shows and interacting with investors;
- (c) issuer (assessee) to review the institutional order books of lead manager and other managers;
- (d) lead manager assist in fixing the price;
- (e) after analysis of the order books in detail, lead manager suggests size and allocation of the issue;
- (f) assistance in issuing final offering circular;
- (g) compliance with statutory and corporate requirements of laws of which the assessee-company is not familiar.

48. In short, according to Mr. Kapila, the above services rendered by the managers before 9th Nov., 1994, would establish the fact that none of the agreements entered into on 9th Nov., 1994, would have been executed but for those services. All technical services, according to him, were rendered by the managers six months prior to 9th Nov., 1994. It all started with the Board meeting on 22nd Feb., 1994, where the proposal to issue GDRs was discussed. He pointed out that even according to the assessee, payments were made for certain advisory work, planning, arranging of offering, road shows and fees for legal counsel, etc. prior to 9th Nov., 1994 (refer to p. 5 of the order under s. 195). In fact the road shows started on 17th Oct., 1994, as stated by the AO in para. 5 of the aforesaid order. He also drew our attention to the Board resolution passed on 29th Sept., 1994 (pp. 81 to 85 of the Department's paper book), which adverted to what he described as certain "very important inputs given by Merrill Lynch" such as suggestions and advice regarding the size of the issue, mode of raising funds and the premium to be charged in consultation with it

(Merrill Lynch), etc.

49. Mr. Kapila further submitted that "this contract (the one dt. 23rd Oct., 1994) is between the assessee and Merrill Lynch Asia Pacific and not Merrill Lynch International which stepped in only later." According to him, the agreement dt. 9th Nov., 1994 does not refer to the contract dt. 23rd Oct., 1994 nor does it supersede the same and that the two had independent existence. He pointed out that the assessee-company had entered into agreements directly with all the managers and had thus utilised their services. He further made a distinction between the "selling group" to which the assessee paid "selling concession" and the "underwriters" to the GDR issue who were different from the "selling group". This distinction, according to him was vital especially for the purpose of r. 144A under which there was no underwriting at all since it is only a "private circulatory offer" to qualified institutional buyers.

50. In our humble understanding, the preliminary argument of Mr. Kapila is relevant in the context of the following questions :

(a) Should any distinction be made between the position prior to 9th Nov., 1994 and the position after the said date and why ?

(b) What was the nature of the services, if any, rendered by the lead managers (Merrill Lynch) before 9th Nov., 1994 and under the letter dt. 26th Sept., 1994, which became a contract when it was signed on behalf of the assessee on 23rd Oct., 1994 ?

(c) If everything has been done before 9th Nov., 1994 and the subscription of the GDRs has been fully ensured then what is to be underwritten under the 9th Nov., 1994 agreements ?

51. We must confess to some difficulty in following the line of Mr. Kapila's argument on the preliminary points. The letter written by Merrill Lynch Asia Pacific Region to the assessee on 26th Sept., 1994, (the "offer letter"), does show that even earlier there had been discussions on the subject of engaging the services of Merrill Lynch as lead managers to the GDR issue. In the said letter, Merrill Lynch had formally expressed its interest in playing a significant role in connection with the issue by acting as "lead manager, book runner and underwriter for the offering". The letter conferred authority in Merrill Lynch to proceed with the "necessary arrangements". Merrill Lynch was to prepare the prospectus to "international investor standards". The assessee-company has to assist Merrill Lynch by providing all information and by participating in the due diligence process. It will also participate in the "marketing efforts" undertaken by Merrill Lynch. Its senior management staff has to participate in making arrangements for "road shows". The letter also provides for joint **d**etermination of the timing of the issue. It was for the company to obtain all prior approvals as per Indian legal requirements. As for such approvals to be obtained outside India, the company will abide by the advice and assistance of Merrill Lynch. A "gross underwriting spread" of 3 per cent of the aggregate subscription price of the GDRs and expenses to be reimbursed was agreed upon. It was also agreed that when formal contracts are entered into they will supersede the terms of the letter and by such formal contracts the terms of the letter may be modified or amended. It is only in accordance with the terms of this letter that subsequent contracts were entered into on 9th Nov., 1994. Elaborate and meticulous documentation was prepared which is only to be expected considering the importance of the arrangement and the parties involved. No doubt certain terms were modified as for example the fees payable which was a consolidated 3 per cent plus expenses as per the letter but was specified clearly under three different heads in the "subscription agreement". But from this it does not follow, with respect to Mr. Kapila's argument, that we have to view the entire arrangement under two water-tight compartments—one before 9th Nov., 1994 and the other after 9th Nov., 1994. The arrangement is only one that Merrill Lynch will act as lead managers to the issue and that there will be other managers. In the very nature of things, the venture to issue GDRs in foreign countries must have had different stages of evolution—the embryo stage, the initial or nascent stages where tentative agreements have to be entered into and only then the final agreements clearly **d**efining the parameters of the arrangement and the

rights and responsibilities of the parties concerned would have come into being. It is a continuous flow or chain of events culminating in the issue of the GDRs. Therefore, our answer to the question (a) above is in the negative.

52. So far as the question (b) is concerned, we would prefer not to answer the same now, since the main question regarding the nature of the services rendered by the managers would also **decide** the same.

53. As regards the question (c), the answer would be that even assuming that the r. 144A GDRs were to be issued only in favour of qualified institutional buyers in USA from whom there is already a firm commitment and consequently there would be no need for underwriting anything with regard to this part of the issue, still the lead managers have to act as underwriters in respect of the other part of the issue where there is no such firm commitment and no qualified institutional buyers. The services rendered by the managers did not come to an end on the entering of the agreements on 9th Nov., 1994. They continued under the agreements entered into on the said date.

54. While **dealing** with this preliminary point raised by Mr. Kapila, we must also notice the charge levelled by him in the course of his arguments that the assessee did not bring all the facts to the notice of the IT authorities and that the preliminary offering circular was not placed before them. He drew our attention to p. 302 of the paper book filed by the assessee, which is the bill raised on the assessee on 15th **Dec.**, 1994, for printing charges in connection with the preliminary and final offering circulars. He also charged the assessee-company with "lack of bona fides" for not having mentioned to the IT authorities the contract dt. 23rd Oct., 1994. Another charge laid by him was that the assessee-company did not inform the RBI about the appointment of DSP Financial Consultants Ltd. as "co-lead manager" along with Merrill Lynch.

55. The first of these charges was countered by Mr. Dastur for the assessee by saying that the preliminary offering letter was part of the final offering circular dt. 9th Nov., 1994, which was unquestionably before the IT authorities. In our opinion, this controversy is needless to be **decided** in this case. Firstly, the assessee-company had undertaken to file the preliminary offering memorandum with SEBI, the concerned stock exchange and the Registrar of Companies—see assessee's letter dt. 15th Sept., 1994 to the RBI at p. 77 of the paper book filed by the **Department**. There is nothing to show that this undertaking was not complied with. Having filed it with some wings of the Government of India, the assessee could have had no motive to withhold the same from the IT authorities. Secondly, even if it is assumed that it was not filed with the IT authorities, that does not appear to us to be quite an intentional omission with any oblique motive, considering that all the other documentation has been filed with them, both relating to events prior to 9th Nov., 1994 and after that date. The order passed by the AO under s. 195 bears testimony to this. Thirdly, the case of the **Department** that certain services were rendered by the managers much before 9th Nov., 1994, stands established even by the other documents filed before us and before the IT authorities.

56. The other charge that the assessee-company did not inform the concerned authorities (RBI, IT **Department**, etc.) about the appointment of DSP as co-lead managers to the issue is not justified because all the papers (pp. 38,42,54,65,69 and 72 of the **Department's** paper book) to which our attention was drawn to substantiate the charge are letters written by persons other than the assessee, **describing** DSP as "co-lead manager". None of them is a letter written by the assessee. However, in the subscription agreement, DSP is **described** as a "lead manager" long with Goldman Sachs and Merrill Lynch. In the assessee's letter dt. 11th **Dec.**, 1998, DSP has been **described** as a "lead manager" in the first page, but in para 17 at p. 5 the assessee has clarified that "Merrill Lynch were the lead managers and others were co-managers" and that "DSP Financial Consultants Ltd. represents Merrill Lynch in India". There is no doubt some confusion as to the status of the DSP but going by the subscription agreement it is clear that it is a co-lead manager along with Merrill Lynch and Goldman Sachs. But it is difficult to accept that the misdescription indicated any lack of bona fides on the part of the assessee-company or that it was **designed** to mislead or

misdirect the IT authorities.

57. We have given careful thought the consideration to the matter, which we found to be not free from difficulty. Let us first take up the question whether an underwriting activity can be called a "technical service" within the meaning of s. 9(1)(vii) r/w Expln, 2 thereto. This takes us to the question whether there was any underwriting at all in respect of the r. 144A GDRs issued to the qualified institutional buyers in USA. There were no doubt certain services rendered by the lead managers in connection with the GDR issue. This is clear from the letter dt. 26th Sept., 1994, written by them to the assessee-company accepting their appointment. The letter lists out the various services contemplated by the parties. These are as under :

- (a) Merrill Lynch will act as lead managers, book runners and underwriters for the offering;
- (b) The prospectus is to be prepared by the lead managers together with the assessee-company to international investor standards and with due diligence;
- (c) Merrill Lynch will make marketing efforts including "road shows" in which the assessee-company will participate—such presentations will be in cities in the USA, Europe, Japan, Singapore and Hongkong;
- (d) The lead manager will advice and assist the company in obtaining approvals and permissions as are required to be obtained outside India.

The resolution of the Board of Directors of the assessee-company passed on 29th Sept., 1994, a copy of which is at p. 81 of the Department's paper book No. 1, acknowledges the following services rendered by Merrill Lynch.

- (a) Advice/suggestion regarding the size of the issue;
- (b) Mode of raising the funds; and
- (c) The premium to be charged—the final decision of course to rest with the company.

58. The whole exercise had started, as pointed out by Mr. Kapila, much earlier than 9th Nov., 1994 and services had also been rendered by the lead managers in connection therewith. As already noted, the arrangement which had been in existence prior to the said date in an informal manner was formalised by agreements entered into on that date. As pointed out by Mr. Kapila, by the time the subscription agreement was entered into on 9th Nov., 1994, there was already a firm commitment from qualified institutional buyers in USA with regard to the r. 144A GDRs. Therefore, his contention that so far as r. 144A GDRs are concerned there was nothing to underwrite appears to us to be correct. But the same thing cannot be said of the issue in Europe and other countries outside USA in respect of which there was no such commitment since they were offered to the investing public. Thus the lead managers were under an obligation to underwrite this part of the issue as on the date of the subscription agreement.

59. The resultant position, according to us, is that there was no underwriting in respect of r. 144A GDRs issued in USA and in respect of the GDRs issued outside USA there was an underwriting. But in respect of both the issues, the other services rendered by the lead managers started much earlier to 9th Nov., 1994.

60. Reverting to the question whether an underwriting activity can be called a "technical service" within the meaning of s. 9(1)(vii) r/w Expln. 2 thereto, we are of the view that Mr. Dastur is right in his contention that it cannot be. We find it difficult to see a person who undertakes the risk of underwriting as one who is rendering a service to the person for whose benefit the risk is

undertaken. An underwriter is under a financial commitment to take up the shares in case the issue is not subscribed fully. This undertaking of the risk does not fall to be considered as a managerial, technical or consultancy service. Thus, our conclusion is that so far as the issue of GDRs outside USA is concerned the underwriting commission of US \$.0938 per GDR cannot be considered as "managerial, technical or consultancy service" within the meaning of s. 9(1)(vii) r/w Expln. 2 thereto. However, we may clarify that the judgment of the Supreme Court in CIT vs. UPSIDC (supra) on which reliance was placed on behalf of the assessee does not advance its case. That **decision** is concerned with the treatment to be given to the underwriting commission in the hands of the underwriting firm which acquired shares of the same company, whose shares it had underwritten. It was held by the Supreme Court that the firm could reduce the cost of the shares by the amount of the underwriting commission. We are unable to understand the judgment as laying down as a general proposition of law that underwriting commission is not income in all cases. The principle laid down by the judgment, in our humble understanding, is confined to cases where the underwriter is called upon to acquire the shares which he had underwritten and also receives commission in respect of that part which is subscribed by the investors. We are afraid that if it is meant to be contended, relying on this **decision**, that underwriting commission can under no circumstances be considered as income, the proposition is put rather too broadly for acceptance. We need not however, consider this **decision** in further **detail** because we have taken the view that underwriting commission, insofar as it relates to the issue of GDRs, outside USA, cannot be considered as managerial, technical, or consultancy service, within the meaning of s. 9(1)(vii) r/w Expln. (2).

61. That takes us to a consideration of the question as to whether the other services rendered by the managers both before and after 9th Nov., 1994, can be considered as "managerial, technical or consultancy services" within the meaning of s. 9(1)(vii) r/w Expln. 2 thereto. It may be recalled that the managers were entitled to a "management commission" or US \$.0938 per GDR under cl. (4) of the subscription agreement. We have already adverted to the rival arguments on this point. On a careful consideration of the same, we are of the view that the various types of services rendered by the managers under the arrangement entered into with the assessee-company, both before and after 9th Nov., 1994, may not fall to be considered as "technical" services but they do bear the characteristics of "managerial" or "consultancy" services. In general parlance, managers are appointed by a company to "manage" the issue. In our opinion, this includes a variety of services to be rendered by them in connection with the issue such as the pricing, timing, size and the efforts needed to be undertaken to market the shares/**debentures**/GDRs. Such efforts, in the case of GDRs, include presentations to be made in foreign countries to potential investors about the company, issue of a **detailed** and informative prospectus, conducting "road shows" and so on and so forth. All these have been undertaken by the managers in the present case. They have also been in constant touch and consultation with the assessee-company with regard to these services. They have also assisted in the compliance with the legal requirements outside India. These, in our view, may have to be viewed sometimes as "managerial" and sometimes as "consultancy" services in connection with the GDR issue. The cannot be strictly segregated into one or the other type and there may be some overlapping.

62. With respect, we are also unable to uphold the arguments of Mr. Dastur that there can be no "managerial services" in respect of an "one-off" transaction, that there should be continuity of services extending to more than one transaction and that such services should have an impact on the "running" of the business. There are no indications to this effect in the section. The only limitation, as per sub-cl. (b), is that the services should be utilised in a business carried on in India, which we have already held to mean that they should be utilised for the purposes of the business carried on in India. The gloss sought to be put by Mr. Dastur that the services should have an impact on the "running" of the business is, with respect, not borne out by the language of the sub-clause. We also understand the argument as impliedly making a distinction between services utilised in the capital field and those utilised in the day-to-day running of the business, a distinction that is again, in our view, not borne out by the language used in the sub-clause. The only condition required by the sub-clause is that the services should have been utilised in a business carried on in

India, whether in the capital field or in the day-to-day running of the business.

63. The other argument placed by Mr. Dastur, viz., that the services rendered by the managers are part of a larger underwriting activity and are only incidental thereto and hence the fees paid for the same must be considered as having been paid only for the underwriting activity might have merited acceptance had it not been for cl. (4) of the subscription agreement which itself makes a distinction between management commission and underwriting commission. This indicates that the parties themselves did not view the services as part of the predominant activity of underwriting. With respect, therefore, the argument cannot be given effect to.

64. We, therefore, conclude :

(1) that the services rendered by the managers are managerial or consultancy services within the meaning of s. 9(1)(vii) r/w Expln. 2 and, therefore, the management commission of US \$.0938 per GDR and the selling commission/concession of US \$.0938 per GDR are income by way of fees for technical services **deemed** to accrue or arise in India;

(2) that part of the underwriting commission of US\$.0938 per GDR, which relates to the GDRs issued in USA under r. 144A to qualified institutional buyers is also income by way of fees for technical services **deemed** to arise or accrue in India; and

(3) that part of the underwriting commission of US \$.0938 per GDR, which relates to the GDRs issued outside USA cannot be considered as income by way of fees for technical services within the meaning of s. 9(1)(vii) r/w Expln. 2 thereto.

(C) Is issuing GDRs part of the business of the assessee-company ?

65. Mr. Dastur put forth an alternative argument that if it be considered that issuing GDRs is part of the assessee's business, then the fees for technical services which were rendered outside India will not be **deemed** to be income accruing or arising in India under s. 9(1)(vii)(b), as the same would fall within the exception mentioned in the said sub-clause. The argument can be accepted only if we find, as a matter of fact, that issuing GDRs is part of the business of the assessee. But there is no basis for this finding. In fact, while making his submissions regarding the other alternative ground, viz., the applicability of the double-tax avoidance agreement (DTAA) with United Kingdom—to which we will refer presently—Mr. Dastur's point was that since the assessee is not in the business of issuing GDRs it cannot be said that the non-resident company (the managers of the GDR issue) had "made available" the technical services or know-how, etc. with regard to the issue of GDRs to the assessee within the meaning of cl. (c) of art. 13, para 4 of the avoidance agreement. Therefore, we, hold that the assessee-company is not in the business of issuing GDRs and, therefore, cannot claim to fall within the exception mentioned in sub-cl. (b) of s. 9(1)(vii) of the IT Act, 1961. This alternative argument is rejected.

Applicability of the Double-tax avoidance agreement with U.K :

66. This second alternative argument of Mr. Dastur, learned counsel for the assessee is perhaps the most important argument advanced by him since acceptance thereof would render the entire gamut of the other arguments already adverted to us wholly academic.

67. Mr. Dastur's argument based on the Double Tax Avoidance Agreement (DTAA) with UK runs like this. According to art. 13.4(c) of the DTAA which came into effect from 26th Oct., 1993, (p. 320 and c. of the paper book filed by the assessee), "fees for technical services" has been **defined** to mean "payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) which make available technical knowledge, experience, skill, know-how or processes, or consist of the

development and transfer of a technical plan or technical design". Under the definition, firstly, managerial services have been excluded. This is a conscious departure from the definition in the earlier DTAA [113 ITR (St) 34] where art. 13.4 used language that was similar to s. 9(1)(vii) and included "managerial" services also in its ambit. Secondly, under the definition in the present DTAA, fees paid for a mere rendering of technical or consultancy services was not sufficient to attract the definition and that it was further necessary that the rendering of such services should result in the "making available", to the assessee, of technical knowledge, experience, etc. which the assessee can use in its business. Applying the definition, it cannot be said that the rendering of services by the managers (Merrill Lynch and others) to the assessee-company in the present case has resulted in the assessee having obtained any technical knowledge, etc. with regard to the issue and marketing of GDRs. The assessee is not in the business of issuing GDRs and that apart, whatever services were rendered by Merrill Lynch and other managers were for the purpose of marketing and selling the GDRs and such services were not made available to the assessee for its further use or utilisation on a reasonably permanent basis.

68. Mr. Dastur then compared the DTAA with UK to the DTAA with USA and pointed out that identical language has been employed in the latter for defining "fees for technical services". The DTAA with USA is placed at pp. 344-354 of the paper book filed by the assessee. It came into force from 18th Dec., 1990, after the first DTAA with UK but before the second DTAA. The definition in art. 12.4 is of "fees for included services" but there is no dispute that effectively it is of "fees for technical services". It says that "fees for included services" (technical services) means "payment of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) if such services make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design". This is in substance the same as in the UK DTAA. Mr. Dastur also drew our attention to the memorandum of understanding concerning fees for included services, dt. 15th May, 1989. The memorandum of understanding (MOU) explains what is meant by technical services and consultancy services. According to the understanding "technical services" are services requiring expertise in a technology and "consultancy services" are advisory services. It also recognizes that there may be overlapping of the two to some extent. The MOU further says that technical and consultancy services are considered "included services" (i.e., as technical services) only to the extent that they make available technical knowledge, experience, etc. It further says that consultancy services which are not of a technical nature cannot be considered as included services (i.e., technical services).

69. Mr. Dastur further drew our attention to the following observations in the MOU.

"Generally speaking, technology will be considered "made available" when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills, etc. are made available to the person purchasing the service, within the meaning of para 4 (b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available".

70. The MOU gives certain examples of technology being made available. These are as under :

1. Biotechnical services
2. Food processing
3. Environmental and ecological services
4. Communication through satellite or otherwise

5. Energy conservation
6. Exploration or exploitation of mineral oil or natural gas
7. Geological surveys
8. Scientific services
9. Technical training

It was pointed out by him that financial services are significantly absent and that underwriting being a financial commitment or a financial activity, has not been understood as falling within the expression "technical or consultancy services".

71. Mr. Dastur also relied on examples 4 and 5 given in the MOU which according to him fitted the assessee's case admirably. He particularly relied on example 4 and contended that as in the example, in the present case also, Merrill Lynch was only performing a contractual obligation for underwriting or the sale of the GDRs and there was no making available of any technical knowledge, experience, etc. to the assessee.

72. In summing up the aforesaid submissions, Mr. Dastur pithily stated that in the present case nothing was made available to the assessee since, to put it in his own words, "at the end of the day, the assessee is still left only with know-how to make suitings, cement, etc. and cannot do what Merrill Lynch can do."

73. Mr. Dastur then submitted that a DTAA with one country can be compared with the DTAA with another country in case of ambiguity and in order to understand the true scope and meaning of the concerned DTAA. He cited the judgment of the Karnataka High Court in the case of AEG Telefunken vs. CIT (1999) 151 CTR (Kar) 222 : (1998) 233 ITR 129 (Kar) where the DTAA with German Democratic Republic was compared with the DTAA with Finland towards this end. Taking inspiration from this, Mr. Dastur compared the DTAA with UK with DTAA entered into with Belgium, Canada, Denmark, Sweden, etc. to point out that in these DTAAs "managerial services" are also included in the definition of "technical services". He pointed out that this shows that the Government of India have consciously taken a decision to exclude the managerial services from the purview of technical services in the agreement with U.K.

74. In support of the contention that the provisions of the DTAA would prevail over the provisions of the IT Act, Mr. Dastur relied on s. 90(2) of the IT Act which was inserted by Finance (No. 2) Act, 1991, with retrospective effect from 1st April, 1972 and also the following judgments :

1. CIT vs. Visakhapatnam Port Trust (1984) 38 CTR (AP) 1 : (1983) 144 ITR 146 (AP)
2. CIT vs. Davy Ashmore India Ltd. (1991) 190 ITR 626 (Cal)

He also cited Circular No. 333 issued by the CBDT on 2nd April, 1982, confirming this position [see (1982) 137 ITR (St) 1].

75. Mr. Dastur also pointed out that "professional services" were separately dealt with in art. 15 of the DTAA with UK and contrasted the same with s. 80-O of the IT Act where managerial services are defined to include professional services. In art. 15.3 of the DTAA with UK, professional services are defined to include independent activities of physicians, surgeons, lawyers, accountants, engineers, architects, etc. as well as independent scientific, literary, artistic, educational or teaching activities. In this connection, he referred to para 18.5 at p. 24 of the order of the CIT(A), where the latter has relied on s. 80RRA of the IT Act which defines "technician" to include a person

having specialised knowledge and experience in accountancy and submitted that the special **de** finition is only for the purposes of that particular section since normally an accountant is never considered to be a technician. At any rate, submitted Mr. Dastur, the CIT(A) was off the mark in equating the profession of accountancy with underwriting activity, both of which are quite different from each other.

76. While winding up his submissions based on the provisions of the DTAA with UK, Mr. Dastur submitted that if the services rendered by the managers of the GDR issue are not technical services within the meaning of the DTAA and the fees paid to them cannot, therefore, be considered as fees for technical services, then the fees will have to be considered as business profits under art. 7 of the DTAA and since it is nobody's case that the managers have a permanent establishment in India, the fees cannot be considered as their income chargeable to tax in India and consequently the assessee cannot be held liable for **de** ducting income-tax therefrom.

77. The above is the summary of the arguments of Mr. Dastur for the assessee, on the applicability of the DTAA with UK.

78. Mr. Kapila for the **De** partment countered the above arguments as under. His first point goes to the root of the matter, viz., the applicability of the DTAA with UK. According to him, the agreement dt. 23rd Oct., 1994 was between the assessee-company and Merrill Lynch (Asia Pacific region), Hongkong. There is no DTAA between India and Hongkong and, therefore, the arguments based on the DTAA with UK are wholly irrelevant. So is the position with regard to the agreement with Goldman Sachs which is based in Hongkong. As regards DSP Financial Consultants, it was an Indian company and there is no question of any DTAA being applicable. As regards Barclays, its origin is not known. Thus, the DTAA with UK is not applicable to any case. In the alternative, Mr. Kapila contended that (assuming there was a payment) the amounts were received by the lead managers on behalf of all the other managers and since the lead managers were based in Hongkong with whom India has no DTAA, there is no question of applying any DTAA. His other alternative argument was that at least 90 per cent of the fees relates to services rendered by Merrill Lynch (Asia Pacific region, Hongkong, before 9th Nov., 1994, and that even on this basis the DTAA with UK has no application. He also pointed out that with regard to the expenses of US \$ 250,000 incurred prior to 9th Nov., 1994, for which there was no break-up, it must be considered as a payment to the lead managers based in Hongkong with whom India has no treaty. The amount was, therefore, fully taxable.

79. As regards the interpretation of double tax treaties between countries, Mr. Kapila submitted that they were binding only on the parties thereto. The letters of understanding under one treaty cannot, therefore, be applied to the interpretation of another treaty with another country. The MOU under the US treaty (DTAA) on which reliance was placed by Mr. Dastur for the assessee, according to Mr. Kapila, cannot, therefore, be looked into for understanding the provisions of the DTAA with UK. He pointed out that the words "which enables the person acquiring the services to apply the technology contained therein" appearing in art. 12.4(b) of the DTAA with Singapore entered into on 8th Aug., 1994 are missing in the concerned article in the DTAA with UK. Only if such words are present in the concerned article in the DTAA with UK can it be successfully contended, says Mr. Kapila for the **De** partment, that the payer of the fees must be in a position to apply the technology in future for its own use and so long as words to that effect are not present in the concerned article it is sufficient if the payer of the fees has enjoyed or utilised the services of the non-resident.

80. Mr. Kapila's further contention was with regard to the meaning of the words "make available". According to him, these words must be given their ordinary meaning without restricting or expanding the same as in the DTAA with Singapore and in the MOU under the DTAA with USA. The ordinary meaning of these words appearing in art. 13.4(c) of the DTAA with UK, in his own words, was "allowing somebody to make use of (the services), whether actually made use of or not".

81. Making a distinction between financial and technical services, Mr. Kapila pointed out that

fixation of the price at which the GDRs were to be issued was a technical exercise which was made available by the lead managers to the assessee-company. So were the legal services rendered in connection with the compliance with the laws of countries outside India. All these services were "made available" to the assessee and the assessee actually made use of them.

82. Adverting to the argument based on art. 15 of the DTAA with UK, on which reliance had been placed by Mr. Dastur to point out that the "professional services" have been considered outside the scope of "technical services", Mr. Kapila pointed out that nothing turned on the meaning of that article which was applicable only to individuals and not to companies or partnership firms.

83. Mr. Kapila also filed extracts from the "Handbook of Financial Terms" by Peter Males and Nicholas Terry to explain the meaning of the term "technical analysis" (see p. 377 of the paper book) which is as under:

"technical analysis. A branch of market or security analysis based upon the study of price movements and trading volume and the forecasting of future movements from past movements (of fundamental analysis). It seeks to gather insights about price trends due to demand and supply and behavioural characteristics of markets which can be used to make predictions about future behaviour. Such analysis relies on many different approaches, the following being the most common : volume and open interest trends, price patterns, relative values (such as price earnings, relative yield), reversals, sentiment, continuation and momentum models, gap theories, mean reversion, mathematical and statistical models such as relative strength, trading rules, seasonability, the Elliot wave, and other anomalies. Such research relies heavily on quantitative methods using high capacity computers or charts, this latter approach being also known as chart analysis or chartism. As such, the techniques are not directly concerned with the fundamental analysis of the underlying. The results lead to investment strategies such as index arbitrage or program trading, which is a form of applied technical analysis aimed at exploiting the observed short-run price differences between markets. A person who makes predictions based on the techniques is known as a technical analyst (of quant)."

84. In his reply to the above arguments, Mr. Dastur, learned counsel for the assessee, relying on paras 28 to 38 of the order under s. 195, submitted that the AO himself had applied the provisions of the DTAA with UK and, therefore, it is no longer open to the Department to raise the point that the said DTAA was not applicable. The AO has even adopted, it was pointed out, the rate of tax of 15 per cent as per art. 13 of the DTAA. Mr. Dastur also took this opportunity to point out that the charge of the Department before us that the assessee-company did not point out the UK moorings of Merrill Lynch (vis-a-vis the fact that the agreement dt. 23rd Oct., 1994, was in the letterhead of Merrill Lynch Asia Pacific Region, Hongkong) was baseless, as unless the assessee had informed the fact that Merrill Lynch was based in UK the AO would not have come to know of it. Thus, in the light of the fact that even in the proceedings before the AO there was no dispute that the UK treaty was applicable, no question about the applicability thereof can be permitted to be raised at this stage. Even on merits, it was submitted that the assessee always looked to Merrill Lynch for anything in connection with the GDR issue. To show the importance of Merrill Lynch, our attention was drawn to cl. (C) of the preamble to the subscription agreement which gave the option of subscribing to 6,28,140 GDRs only to Merrill Lynch. Our attention was also drawn to various other clauses in the agreement which gave certain rights to Merrill Lynch such as the right to determine whether there has been a mis-statement in the offering circular, disability of the assessee to issue any securities in the same class as the GDRs before a particular time-limit after the closing date without the written consent of Merrill Lynch, the right to terminate the agreement on behalf of the managers on the happening of certain events, etc. The payment of 3 per cent commission was made only to Merrill Lynch. The assessee has affirmed it in its letter dt. 26th Nov., 1998 to the AO. The lead manager, in turn, paid the co-managers out of the same. Thus, the other managers would receive the commission from Merrill Lynch and not from the assessee. This position was in conformity with cl. 5(d) of the managers' agreement dt. 9th Nov., 1994 (pp. 9 to 13 of the Department's paper book No. 1). Thus, the payment was unquestionably made to Merrill Lynch, UK

with whom the assessee was concerned. It was, therefore, contended that the AO had rightly applied the UK treaty.

85. On the merits of the contentions advanced on behalf of the Revenue vis-a-vis the meaning of the term "make available", Mr. Dastur contended that they overlooked the position that under art. 13.4(c) of the DTAA with UK the rendering of the services by the non-resident was qualified by the words "which....make available" which put it beyond doubt that a mere rendering and utilisation of the services would not do and that it was further necessary that the person utilising the services should be in a position to make use of those services (in his business) all by himself without resorting to the non-resident again. In the words of Mr. Dastur, the acquisition of "something of value which the assessee can make use of is necessary" and in this case whatever was made available to the assessee-company worked itself out the moment the GDRs were issued. Something must remain available to the assessee over and above the benefit **derived** from rendering the services which is covered by the first part of art. 13.4 and the assessee must be in a position to apply the benefit of those services in future. He relied on the **definition** of the words "make available" given in Oxford Dictionary to mean that something should be within one's reach so that one can use it.

86. As regards the principles to be applied to the interpretation of DTAAs, Mr. Dastur submitted that the Singapore and US agreements can certainly be looked into as "aids to construction" and cannot be ignored. He submitted that the MOU explained the treaty with USA which was entered into in 1990, whereas in the 1994 treaty with Singapore it was made part of the relevant article itself which showed that it was a process of evolution enriched by experience. Therefore, it was contended, one can certainly look into the Singapore and US treaties in order to understand the scope and intent of the UK treaty.

87. With regard to the payment made to Goldman Sachs and Barclays, Mr. Dastur fairly stated that since there was no DTAA with Hongkong (they are based in Hongkong) there was no question of applying any DTAA, but submitted that even then only the income portion of the underwriting commission received by them was taxable and not the entire commission, meaning thereby that the expenses to earn the income shall have to be **deducted**.

88. We have carefully considered the matter. At the outset it may be stated that there was no dispute that the DTAA, if one is applicable, would govern the case. Even Mr. Kapila's preliminary contention was only that the DTAA with UK was not applicable on the facts of the case. We, therefore, proceed to examine firstly whether he is right. In our opinion, having regard to the fact that the AO himself did not dispute the applicability of the DTAA with UK, Mr. Kapila, with respect, cannot now be heard to say that it did not apply to the case. Paras 28 to 38 of the order under s. 195 are quite elaborate on this. The AO, in these Paras, has examined the applicability of the DTAA with UK on merits without ever raising the objection that it does not apply in the first place. Mr. Dastur is, therefore, right, in our view, in saying that the Revenue cannot now raise the point. The CIT(A) is also not correct in saying that the question of applicability of the DTAA with UK is academic. Further, we cannot possibly infer that the assessee had impliedly admitted [as the CIT (A) says] that the fees paid were taxable in India, merely from the facts that the assessee did not make any application to the AO under s. 195(2) for **determination** of the appropriate proportion of the sum which is chargeable to tax.

89. Even on merits, the objection of the Revenue that the UK agreement does not apply cannot be upheld. The clauses in the managers' agreement dt. 9th Nov., 1994 to which our attention was drawn on behalf of the assessee show the importance of Merrill Lynch in the issue of GDRs. It was appointed the lead manager. Even the payment was to be made only to Merrill Lynch and the same was to be distributed by Merrill Lynch to the other managers. The assessee was thus concerned directly with Merrill Lynch and with the other managers, only through Merrill Lynch. The letter dt. 26th Sept., 1994, which on 23rd Oct., 1994 became a contract between the assessee and Merrill Lynch has no doubt been written by the Asia Pacific Regional office of Merrill Lynch but that, it is

reasonable to assume, is only because it was the regional office of Merrill Lynch of UK. As it turned out later, the subscription agreement was entered into with Merrill Lynch of UK. We have already seen that there can be no water-light compartmentalisation between what happened before and after 9th Nov., 1994. Nothing has been brought to record to show that Merrill Lynch UK has disowned the contract of appointment or the terms and conditions thereof embodied in the letter dt. 26th Sept., 1994 which was signed by the assessee-company on 23rd Oct., 1994. This letter refers to "Merrill Lynch International Ltd." which is situated in UK. The appointment as lead manager is of Merrill Lynch international Ltd. as is clear from this letter itself. Further, the subscription agreement is, inter alia, with Merrill Lynch International Ltd. and not with Merrill Lynch Asia Pacific Region, Hongkong. The managers' agreement dt. 9th Nov., 1994 also refers to Merrill Lynch International Ltd. and the complete London address is given therein. Apparently Merrill Lynch International Ltd. of UK negotiated with the assessee-company through its Asia Pacific Regional office in Hongkong in the preliminary stages. But from that it cannot be said that the assessee utilised the services of the Asia Pacific Regional office of Merrill Lynch, which was located in Hongkong, and, therefore, the UK treaty does not apply. Mr. Kapila's preliminary objection cannot, therefore, stand even on merits.

What is the meaning and scope of the words "fees for technical services" appearing in art. 13.4(c) of the DTAA with U.K. ?

90. Having thus held that the UK agreement of 1993 was rightly applied by the AO, we now proceed to a consideration of the question as to the meaning and scope of art. 13.4 of the same. On a very careful consideration of the rival contentions which were, with respect, presented before us with admirable clarity, ability and assiduity by both sides, we find ourselves persuaded to agree with the assessee's contentions with regard to the interpretation to be placed on the aforesaid article. The language used in the article, first of all, excludes "managerial services". We have, therefore, to interpret the "technical and consultancy" services. The article may be extracted below.

"4. For the purposes of para 2 of this Article, and subject to para 5 of this Article, the term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) which :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment **described** in para 3(a) of this Article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment **described** in para 3(b) of this Article is received; or

(c) make available technical knowledge, experience, skill, know-how or processes, or consist of the **development** and transfer of a technical plan or technical **design**.

5. The **definitions** of fees for technical services in para 4 of this Article shall not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property **described** in para 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic,

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as **defined** in art. 15 (independent personal services) of this Convention."

The **definition** of "technical services" in art. 13.4 of the earlier DTAA agreement with UK which was superseded by the 1993 agreement, was similar to the language employed in s. 9(1)(vii) of the IT Act, 1961 and included "managerial" services. But in the subsequent agreement in 1993, the art. 13.4(c) used different language as may be seen. It dropped the "managerial" services. There are also significant additions. It is, however, common ground that art. 13.5 does not apply. We should also keep in view the gentle but firm reminder of Mr. Dastur that in the meantime (1990) India had entered into a DTAA with USA and also a MOU thereunder in which the parties thereto had understood the **definition** in a particular way and there was no reason why the parties would not have intended to give the same meaning to the identical **definition** in the subsequent DTAA with UK. There is a good **deal** of sense and logic in the argument because it is difficult to postulate that the same country (India) would have intended to give different types of treatment to identically **defined** services rendered by entrepreneurs from different countries. There must be strong and incontrovertible evidence to show such an intendment. We have not been referred to any such evidence on behalf of the Revenue. Thus, not only is there a significant **departure** from the language employed in the first DTAA agreement (which was similar to the IT Act) but the **departure** has also been explained and understood in a particular manner with reference to the US agreement where also the language employed in the concerned article is similar in substance with that employed in the second UK agreement. To, therefore, understand the meaning and scope of the concerned article in the same manner as one would understand the relevant provisions of the IT Act—as suggested on behalf of the **Department** before us—would be totally off the mark.

91. Now we have to see if the meaning ascribed to the words "make available" by Mr. Dastur is acceptable or reasonable. Whereas s. 9(1)(vii) stops with the "rendering" of technical services, the DTAA goes further and qualifies such rendering of services with words to the effect that the services should also make available technical knowledge, experience, skills, etc. to the person utilising the services. These words are "which make available". The meaning ascribed by Mr. Kapila for the **Department** is that these words merely mean "to allow somebody to make use of, whether actually made use of or not", but in our opinion and with respect, this meaning does not take due note of the addition of such words to the "rendering of any technical or consultancy services". The meaning suggested by Mr. Kapila is embedded in the "rendering" of the services itself. When somebody "renders" services, it presupposes that somebody else is "making use" of the same. But the "making use of" should be contrasted with the "making available". The "making available", in our opinion, refers to the stage subsequent to the "making use of" stage. The qualifying word is "which"—the use of this relative pronoun as a conjunction is to **denote** some additional function the "rendering of services" must fulfil. And that is that it should also "make available" technical knowledge, experience, skill, etc. In grammar, the word "which" is called a relative pronoun "because it refers or relates (i.e., carries us back) to some noun going before, which is called its Antecedent" [see High School English Grammar and Compositions by Wren & Martin (1994), revised edition, p. 45]. The noun going before the relative pronoun "which" in the article is "services". At pp. 46 and 47 of the same book by Wren & Martin, it is stated as under :

"Note : The relative pronouns "who" and "which" can be used :

(i) To restrict, limit, or **define** more clearly the antecedent;

(ii) To give some additional information about the antecedent;"

(underlining, italicised in print, ours)

92. We hold that the word "which" occurring in the article after the word "services" and before the

words "make available" not only **describes** or **defines** more clearly the antecedent noun ("services") but also gives additional information about the same in the sense that it requires that the services should result in making available to the user technical knowledge, experience, skill, etc. Thus, the normal, plain and grammatical meaning of the language employed, in our understanding, is that a mere rendering of services is not roped in unless the person utilising the services is able to make use of the technical knowledge, etc. by himself in his business or for his own benefit and without recourse to the performer of the services in future. The technical knowledge, experience, skill, etc. must remain with the person utilising the services even after the rendering of the services has come to an end. A transmission of the technical knowledge, experience, skills, etc. from the person rendering the services to the person utilising the same is contemplated by the article. Some sort of durability or permanency of the result of the "rendering of services" is envisaged which will remain at the disposal of the person utilising the services. The fruits of the services should remain available to the person utilising the services in some concrete shape such as technical knowledge, experience, skills, etc.

93. In the present case, as Mr. Dastur pertinently pointed out, after the services of the managers (Merrill Lynch and other co-managers) came to an end, the assessee-company is left with no technical knowledge, experience, skill, etc. and still continues to manufacture cement, suiting, etc. as in the past.

94. The MOU appended to the DTAA with USA and the Singapore DTAA can be looked into as aids to the construction of the UK DTAA. They **deal** with the same subject (fees for technical services, referred to in the US agreement as "fees for included services"). As noted earlier, it cannot be said that different meanings should be assigned to the US and UK agreements merely because of the MOU **despite** the fact that the subject-matter **dealt** with is the same and both have been entered into by the same country on one side (India). The MOU supports the contention of the assessee regarding the interpretation of the words "make available". The portions of the MOU explaining para 4(b) of the relevant article, which we have extracted earlier in our order while adverting to the contentions of the assessee, fully support its interpretation. Example (4) given in the MOU also supports it. This is of a US company manufacturing wallboard for the assessee using assessee's raw material but using its own plant. No technical knowledge, experience, skills, plan or **design** is held to have been made available in such a case. However, in contrast, example (5) is of a US company rendering certain services in connection with modifying the software used by the Indian company to suit a particular purpose. A modified computer software programme is supplied by the US company to the Indian company. It is, therefore, held that there is a transfer of a technical plan (i.e., computer software) which the US company has **develo**ped and made available to the Indian company. The fees are chargeable. These examples affirm the position taken by the assessee-company before us as to the interpretation of the words "make available".

95. Art. 12.4(b) of the DTAA with Singapore was relied on by both sides—by Mr. Dastur to show that the words used therein, viz., "if such services....make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein....." merely make it explicit what is meant by "make available" while Mr. Kapila contended that these words being absent in the DTAA with UK, it indicates that the assessee-company need not be in a position to apply the technology for its own use in future without recourse to the person rendering the services. On a careful consideration of the matter, we are of opinion that the addition of these words in the Singapore DTAA merely make it explicit what is embedded in the words "make available" appearing in the DTAA with UK and USA. The MOU under the US DTAA and the examples given thereunder, to which we have already referred, make it clear. The meaning of those words were expressly incorporated in the Singapore agreement by adding the necessary words. What would be the use of coining the words "make available" if it is not intended, as contended by Mr. Kapila, that the person utilising the services should be in a position to apply the technology for his own use in his business in future without recourse to the person rendering the services ? Would it not be a contradiction in terms to say that though the technical knowledge, etc. are "made available", the person to whom they are made available

cannot apply the same for his benefit ? The treaties, in our opinion, could not have intended such a result. What was, therefore, implicit in the concerned articles in the UK and US DTAA was made explicit by adding the necessary words in the Singapore agreements. As Mr. Dastur rightly remarked, it is a process of evolution guided by experience and what started in 1990—the DTAA with the US—as a MOU gradually crystallised and got incorporated in the articles itself in the DTAA with Singapore.

96. Contrast the **definition** of "fees for technical services" in art. 3(b) of the DTAA with Belgium, art. 13.4 of the DTAA with Canada, art. 13.4 of the DTAA with **Denmark** and art. 13.4 of the DTAA with Sweden. In all these articles, the **definition** is substantially the same as in the superseded DTAA with UK and in s. 9(1)(vii) of the IT Act. Thus, a different intention has been expressed in these articles, which include managerial services within the fold of technical services and also do not contain words indicating that the rendering of services should "make available" technical knowledge, experience, skill, etc. We cannot give the same meaning to words differently **defined** in two sets of DTAA, which would be the result if we accept what has been argued before us on behalf of the **Department**.

97. For the above reasons, we are of the considered opinion that (1) the DTAA with UK applies to the present case and (2) no technical knowledge, experience, skills, know-how or process, etc. was "made available" to the assessee-company by the non-resident managers to the GDR issue (Merrill Lynch and others) within the meaning of art. 13.4(c) of the DTAA.

What happens if the DTAA with UK is applicable ?

98. We now proceed to consider the consequence of our conclusion that the DTAA with UK is applicable to the present case.

99. It was very fairly stated by Mr. Kapila, learned representative for the Revenue, that if the DTAA is held applicable, then no part of the fees for "managerial services" can be considered as fees for technical services, since the word "managerial" does not find a place in the article concerned. There can be no two opinions about his view. We, therefore, hold that the "management commission" of US\$.0938 per GDR cannot be charged to tax in the hands of Merrill Lynch to whom the same is paid. The assessee-company consequently was under no obligation to **deduct** tax under s. 195. We hold accordingly.

100. As regards the "underwriting commission", in view of the foregoing discussion, we have to hold that no technical knowledge, etc. was made available to the assessee-company by the rendering of the underwriting services and, therefore, the **definition** in the DTAA is not applicable.

101. As regards "selling concession" or "selling commission", Mr. Dastur relies on Circular No. 786, dt. 7th Feb., 2000, [published at (2000) 158 CTR (St) 61] (copy placed at pp. 318-319 of the paper book filed by the assessee) to contend that it is not income in the hands of the recipient. We have gone through the circular. It is applicable to export commission paid by an assessee to a non-resident for services rendered by the latter outside India. The CAG had raised an objection that since no tax was **deducted** from the commission by the resident, s. 40(a)(i) of the Act applied and the commission cannot be allowed in the assessment as a **deduction**. The Board, following its earlier circular issued in 1969, took the view that the commission cannot be considered as income arising to the non-resident agent operating outside India and, therefore, no tax was **deductible** under s. 195. The view point was explained to the CAG who had agreed to drop the objection.

102. The circular prima facie appears to support the assessee but we are unable to give effect to the same in the view we have taken regarding the interpretation of the words "technical services" appearing in s. 9(1)(vii) r/w Expln. 2. It may be recalled that we have taken the view that the services rendered by the lead manager and other managers in connection with the GDR issue shall be considered as "managerial" or "consultancy" services. The circular would appear to take a

contrary view. However, the circular has no application where the interpretation of the relevant article in the DTAA is involved. It has been issued in connection with s. 195 of the Act. In the view we have taken of the import of the words "make available" appearing in art. 13.4(c) of the DTAA with UK, it is unnecessary for us to dilate on the circular further. In fact, the reference to the circular in connection with the interpretation of the said article, with respect, would appear to be out of place.

103. For the above reasons, we hold that neither the management commission nor the underwriting commission nor even the selling commission/concession would amount to fees for technical services within the meaning of the DTAA with UK and consequently there is no obligation on the part of the assessee-company to **deduct** tax under s. 195.

No payment, no credit—Is s. 195 applicable ?

104. One of the arguments of Mr. Dastur was that since the amount payable to Merrill Lynch was not actually paid but was allowed to be **deducted** out of the sale proceeds of the GDR issue there was neither a payment to Merrill Lynch nor a credit in its favour and, therefore, s. 195 is not attracted. At our instance, he explained the accounting entries made in this behalf by the assessee-company. According to him, s. 195(1) has to be complied with only when there is a "payment in fact" and not a payment by a **deeming** or a fiction. Reliance was also placed by him on the judgment of the Hon'ble Bombay High Court in Hyundai Heavy Engineering Industries vs. D.C. Pant & Ors. (1994) 120 CTR (Bom) 101 : (1994) 204 ITR 113 (Bom). The contention of Mr. Kapila on the other hand, relying on the judgment of the Supreme Court in J.B. Boda & Co. (P) Ltd. vs. CBDT (1997) 137 CTR (SC) 287 : (1997) 223 ITR 271 (SC) was that the present case is one of actual payment as much as it was an actual receipt in the cited case and there was no need for a "two-way traffic"—receipt of the sale proceeds of the GDR first by the assessee-company from Merrill Lynch and remittance of the amounts under the subscription agreements by the former to the latter.

105. We have seen the accounting entries made in the books (p. 49 of the paper book filed by the assessee). They are as follows :

"GDR Issue

Journal Entries 10/5-60921

	Rs.	ps.	Rs.	ps.
1. Bank of America (New York)	191,10,29,390.56			
To GDR issue Suspense (Being the entry for US \$ 60859993.33 received at Bank of America Newyork on 23rd Nov., 1994 from Merrill Lynch after deducting US \$ 1889999.79 and US \$ 2,50,000.00 being their commission & legal expenses)			191,10,29,390.56	
2. GDR Issue Expenses	5,93,46,788.41			
" " "	78,50,105.16			
To GDR Issue Suspense			6,71,96,893.57	
(Being the entry for Merrill Lynch				

Commission US \$ 18,89,999.79
and legal expenses US \$
2,50,000.00 **deducted**)

3. GDR Issue Suspense 197,82,26,284.13

To Share Capital 7,91,45,720.00

To Share Premium 189,90,80,564.13

(Being the entry for 79,14,572
Equity Shares of Rs. 10 each and
balance to share premium A/c.)"

106. It may be seen from the first entry that the amounts due to Merrill Lynch were adjusted against the sale proceeds of the GDRs and only the net amount was taken into account. The second entry is a journal entry to bring into account the expenses such as commission due to Merrill Lynch and the legal expenses. It may be noted that the corresponding credit has not been given to the account of Merrill Lynch, but it has been given to an account styled "GDR Issue Suspense". Such a suspense account is covered by the Explanation inserted below s. 195(1) w.e.f. 1st June, 1987, but that aspect does not appear to have attained any prominence in the present case. The case has proceeded before us as if there was a payment.

107. Now s. 195(1) obliges the person responsible for paying to a non-resident any sum chargeable under the provisions of the IT Act (except salaries) to **deduct** income-tax thereon at the prescribed rates "at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier". In the present case, the proceeds of the GDR issue were remitted to the assessee-company by Merrill Lynch after **deducting** the amounts payable by the assessee-company under the relevant agreements. The question is whether this can amount to "payment". Mr. Kapila's reliance in this behalf on J.B. Boda (supra) appears to us to be well placed. Just as the assessee in that case was held to have "paid" the commission to a person outside India by merely **deducting** the same from the amounts payable to the non-resident and remitting only the balance, the assessee-company before us must be considered to have "paid" the amounts payable to Merrill Lynch under the subscription agreement by permitting the latter to **deduct** the amounts payable to it and remit only the balance. The sub-section mentions different modes of payment—cash, cheque, draft "or any other mode". In our view, an adjustment of the amount payable to the non-resident or **deduction** thereof by the non-resident from the amounts due to the resident-payer (of the income) would fall to be considered under "any other mode". Such adjustment or **deduction** also is equivalent to actual payment. The principle laid down in J.B. Boda's case would squarely apply. Commercial transactions very often take place in the aforesaid manner and the provisions of s. 195 cannot be sought to be **defeated** by contending that an adjustment or **deduction** of the amounts payable to the non-resident cannot be considered as actual payment. The test perhaps is to ask the question whether the resident is relieved of the liability to pay the amount. The answer, in our view, cannot be in the negative.

108. The case also falls under the Explanation below s. 195(1) which was inserted w.e.f. 1st June, 1987. The amount has been credited to the GDR Issue Suspense account and under the Explanation the credit shall be **deemed** to be credit of the income to the account of Merrill Lynch. Thus, there was a credit also in favour of Merrill Lynch by virtue of the Explanation.

109. We, therefore, reject the contention of Mr. Dastur that s. 195 is not attracted since there is no payment to Merrill Lynch. In our view, there is also a credit in favour of Merrill Lynch for the reasons given in the preceding paragraph.

110. We will now consider the following questions :

- (a) Can an order be passed under s. 195(1) ?
- (b) If not, can an order under s. 201 be passed ?
- (c) Is the appeal before the CIT(A) maintainable ?

111. One of the arguments raised on behalf of the assessee was that there was no provision for passing an order under s. 195 in order to **decide** the issues which the AO has raised in para 29 of the order passed by him under s. 195. It was submitted that s. 248 of the IT Act which has been referred to by the AO in this section comes into play only if an application is made to the AO for **determination** of the income subject to **deduction** of tax as per sub-s. (2) of s. 195 and since in the assessee's case no such application was made, there is no question of passing any order under s. 195. Consequently, there can be no order under s. 201 charging interest.

112. On the other hand, Mr. Kapila for the Revenue clarified that there are two appeals in the present case, one against the order under s. 195 and another under s. 201(1) and 201(1A) of the IT Act. He pointed out that the order under s. 195(1) has been made an enclosure to the order under s. 201 which order says that it has to be read in conjunction with the order under s. 195(1). He contended that this is only a matter of form or "style" and that in substance both the orders were **dealt** with by the CIT(A) as one and the same, as was clear from para 18.1 of his order in the appeal against the order under s. 195(1). He agreed that there existed no provision for passing an order under s. 195(1), but submitted that the substance of the matter has to be looked at and not the form in which it has been presented or **dealt** with.

113. On a consideration of the matter, we are of the view that s. 195(1) merely **declares** the liability to **deduct** tax under certain circumstances and does not contemplate the passing of any order, which position has not been contested by Mr. Kapila on behalf of the Revenue. The reference to s. 248 by the AO does not appear to be apposite because that section provides for a right of appeal to a person who **denies** his liability to make the **deduction** of tax, even though he has **deducted** and paid the tax. In other words, it would appear to be a condition for filing an appeal under s. 248 that the person should have **deducted** and paid the tax. Only in such a case, a right of appeal is granted, where he could **deny** his liability to make the **deduction**. In the present case, the assessee has not **deducted** nor paid the tax and, therefore, s. 248 is not applicable to it. Another way of looking at the matter is as Mr. Dastur for the assessee pointed out. According to him, an appeal lies under s. 248 only against an order passed under s. 195(2) which in turn contemplates an application being made by the person paying the same to the non-resident for **determination** by the AO, of the appropriate proportion of the same which is chargeable to tax. There could be a dispute about the proportion **determined** by the AO in which case an appeal lay under s. 248, provided the person **denies** the liability to make the **deduction** as directed by the AO. In either view of the matter, we have to hold in the present case that there is no scope for passing an order under s. 195(1).

114. That, however, does not mean that there would be no order under s. 201 charging interest, as contended by Mr. Dastur. We think that Mr. Kapila is right in his submission that substantively, it is an order under s. 201 of the Act charging interest, in case there is a **default** in **deduction** of tax under s. 195. It is in such an order that the AO has to establish that the assessee was liable to **deduct** tax, which he did not, and is, therefore, to be treated as an assessee in **default**. If there is a **default**, the AO is also empowered to charge interest for the same as contemplated by sub-s. (1A) of the section. Therefore, what all has been stated by the AO in the present case in the order under s. 195 is all that is required to be said in the order passed under s. 201(1)/(1A). Instead of doing so, the AO has **dealt** with the assessee's liability to **deduct** tax under s. 195 elaborately in the order passed under that section and has made this order an enclosure to the order passed under s. 201(1)/(1A). For that reason, it cannot be said that since no order is envisaged under s. 195(1), there cannot be an order passed under s. 201 charging interest. As rightly pointed out by Mr. Kapila, we have to look at the substance of the matter without being carried away by the form

or style in which the AO has **dealt** with the matter. The contention of Mr. Dastur, with respect, perhaps is an extreme stand. We are, therefore, unable to give effect to the same.

115. Mr. Dastur then criticised as "untenable" the view taken by the CIT(A) in para 18.7 of his order passed in the appeal against the order under s. 195. The view taken by the CIT(A) is that a valid order can be passed under s. 195 for the assessee's failure to **deduct** tax under s. 195(1) and also for his failure to file an application under s. 195(2) or s. 195(3). According to him, these sub-sections impose statutory obligations on the assessee and if there is a failure to comply with the same, an order can be passed under s. 195. Mr. Dastur points out that the obligation to **deduct** tax is on the sum chargeable to tax under the IT Act and sub-s. (2) of s. 195 comes into play only if the assessee himself considers that a part of the sum is so chargeable. He refers to the judgment of the Hon'ble Bombay High Court in the case of CIT vs. Cooper Engineering Ltd. (1968) 68 ITR 457 (Bom). As regard the reliance placed by the CIT(A) on the judgment of the Supreme Court in the case of Transmission Corporation vs. CIT (1999) 155 CTR (SC) 489 : (1999) 239 ITR 587 (SC), Mr. Dastur submits that the CIT(A) has (1) taken the observations of the Supreme Court out of context, and (2) has lost sight of certain pertinent observations of the Supreme Court. According to him, the impact of the judgment is that income-tax is to be **deducted** at the rates applicable only on the proportion of income embedded in the gross amount remitted abroad and the CIT(A) has grossly erred in holding that the question as to whether the fees paid to the lead managers are in the nature of "pure income" is not relevant. In this connection, he referred to the observations in the judgment of the Supreme Court as also the judgment of the Andhra Pradesh High Court in CIT vs. Superintending Engg. Upper Sileru (1985) 46 CTR (AP) 238 : (1985) 152 ITR 753 (AP) in the same case which was affirmed by the Supreme Court.

116. Mr. Kapila for the Revenue, however, contends that the question before the Supreme Court in the case of Transmission Corporation (supra) was as to what is the portion of the income embedded in the payment, whereas in the present case the case of the **Department** is that the entire payment is "pure income". He also draws our attention to the judgment of the Calcutta High Court in the case of P.C. Ray vs. A.C. Mukherjee, ITO (1959) 36 ITR 365 (Cal) and submits that this judgment which is approved by the Supreme Court, says that the gross sum must be subjected to tax **deducted** at source.

117. We have carefully considered the question as to whether the liability to **deduct** tax is in respect of the gross sum paid or is limited to the income portion embedded or hidden in the same. A first reading of the judgment of the Supreme Court in the case of Transmission Corporation (supra) no doubt gives the impression that if no application is filed by the assessee under s. 195(2) seeking a **determination** of the appropriate portion of the sum remitted, income-tax on the gross sum has to be **deducted** and paid. However, in the penultimate paragraph of the judgment (p. 596 of the report) the Supreme Court has upheld as correct the answer given by the Andhra Pradesh High Court that the obligation of the assessee to **deduct** tax under s. 195 is limited only to the appropriate proportion of income chargeable under the Act. In our humble understanding of the section in the light of the judgment, the position appears to be like this. The sum paid to the non-resident may be either fully or partly chargeable to income-tax. If it is fully chargeable (pure income) undoubtedly the tax has to be charged at the appropriate rates on the whole of such sum and **deducted** and paid. If the sum is only partly chargeable (embedded or hidden income), the assessee has to apply under s. 195(2) to the AO for **determination** of the appropriate fraction of the income hidden or embedded therein. The AO in that case will have to pass an order on the assessee's application **determining** the appropriate portion. The assessee has a right of appeal against such order under s. 248 but that right of appeal can be exercised only if the tax is **deducted** and paid. In a case where no such application is filed, then according to the judgment, the assessee is liable to **deduct** tax on the footing that the whole sum is chargeable to tax (observations of the Supreme Court at p. 595). This observation has to be, however, reconciled and read with the answers given finally to the questions referred and the view expressed by the Supreme Court on the correctness of the judgment of the High Court. In the penultimate paragraph of the judgment, the Supreme Court upheld that answers given by the High Court that (1) the

assessee in that case was obliged to **deduct** tax under s. 195 "in respect of" (underlining italicised in print ours) the sums paid to the non-resident, and, that (2) the obligation to **deduct** tax was "limited only to the appropriate proportion of income chargeable under the Act". Reading both the observations together and attempting to reconcile the same, we are unable to hold that the assessee in the present case was liable to **deduct** tax at the appropriate rates applied to the whole of the amount paid to the non-resident managers. The assessee was liable to **deduct** tax only on the appropriate proportion (the hidden or embedded income) of the amounts. But in order to do so, the assessee ought to have applied to the AO under s. 195(2). It did not file any such application. Therefore, the assessee ought to have **deducted** tax on the footing that the whole amount represented "pure income". We have to read all the provisions—s. 195(1) and (2) and s. 248—harmoniously and in the light of the judgment of the Supreme Court.

118. Mr. Dastur, however, said that the assessee in Transmission Corporation's case (supra) did not make any application to the AO under s. 195(2) but still the High Court had held that the obligation to **deduct** tax under s. 195 was limited to the appropriate proportion of income chargeable under the Act, which view was affirmed by the Supreme Court. If it is to be held that **despite** not having applied to the AO under s. 195(2), the assessee could still contend that it is liable to **deduct** tax only from the hidden or embedded income and not from the entire sum, that would make sub-s. (2) of s. 195 otiose. Sec. 195 is a provision enacted to safeguard the Revenue and this has to be borne in mind. Apparently, the legislature feels that in the case of a non-resident the tax should be collected first and all nice questions of fact and law can be left to be thrashed out at the time of making the assessment of the non-resident through an agent or otherwise. As the Supreme Court has recognised, the rights of both payer and payee have also been safeguarded, subject to certain conditions being complied with. An application under s. 195(2) is one such provision.

119. To summarise, we hold :

(i) that there is no question of passing any order under sub-s. (1) of s. 195 as the sub-section merely **declares** the liability of the assessee to **deduct** and pay the tax.

(ii) since there is no application under sub-s. (2) for **determination** of the appropriate proportion of the income (hidden or embedded income), and consequently no order under that sub-section, the provisions of s. 248 are not attracted.

(iii) But for that reason the appeal cannot be held invalid because in substance it is against the order under s. 201(1) and (1A) to which the so-called order under s. 195(1) has been made an enclosure. The "order" under s. 195(1) has to be incorporated into and read as part of the order under s. 201(1) and (1A) and so read the effective appeal in law is the one against the said order.

Can the tax be recovered from the assessee-company ?

120. It was contended by Mr. Dastur for the assessee that in the absence of a notice of **demand** served on the assessee, the amount of tax in respect of which the assessee has been considered to be in **default** cannot be recovered. He pointed out that there is no provision in the IT Act to recover the tax. According to him, the only course open to the AO for recovering the tax was to pass an order treating the assessee-company as agent of Merrill Lynch under s.163, make an assessment on the assessee-company on that basis and then proceed to recover the tax after serving a valid notice of **demand** under s.156 pursuant to such an assessment. Having failed to follow this course, it was contented, the AO cannot recover the tax indirectly under s. 195(1).

121. The order passed by the AO under s. 195 contains only a direction that a challan be issued for payment of the tax. It does not contain a direction for issue of a **demand** notice. It is not in dispute before us that no **demand** notice was served on the assessee in respect of the tax. Sec. 156 says that when any tax is payable in consequence of an order passed under the Act, the AO shall serve

on the assessee a **demand** notice in the prescribed form specifying the amount payable. The section refers only to tax payable "in consequence of any order passed under the Act". But since the assessee has successfully contended that there can be no order under s. 195(1)—a position admitted fairly by Mr. Kapila before us—obviously there cannot be a notice of **demand** under this provision in respect of the tax. The order under s. 201(1) is for the purpose of **declaring** the assessee-company as an "assessee in **default**". This order passed by the AO also does not show that a **demand** notice in respect of the tax was issued to the assessee. Only a challan appears to have been issued (vide para 3 of the order). It appears to us to be a settled position under the IT Act that service of a notice of **demand** is a condition precedent for the recovery of the tax. But that is because, as held by the Supreme Court in *M.M. Parikh, ITO vs. Nawanagar Transport & Industries Ltd.* (1967) 63 ITR 663 (SC) the liability to pay tax, until **determined** by meaning of a proper assessment, remains ambulatory and becomes fixed only upon the completion of the assessment. In the case of s. 201 r/w s. 195, it is the failure to **deduct** the tax that visits the assessee with the liability of an "assessee in **default**". This liability, according to the judgment of the Kerala High Court in *Traco Cables Co. Ltd. vs. CIT* (1987) 62 CTR (Ker) 174 : (1987) 166 ITR 278 (Ker) cited by Mr. Kapila in another connection, is cast upon the assessee not because of any assessment order or notice of **demand**, but because of the operation of the statute itself. The liability under s. 195 or s. 201 is at no time ambulatory, but is attracted immediately upon the happening of an event, viz., the failure to **deduct** tax. There is no further requirement of computation or assessment. Once the liability is incurred, no further **demand** is necessary to recover the tax, according to the Kerala High Court. Under the circumstances, we hold that the tax can be recovered from the assessee-company.

122. Mr. Kapila submitted that the IT authorities certainly could have treated the lead manager Merrill Lynch International Ltd. as a **defaulter** through an order passed on the assessee-company under s. 163 making it the agent of Merrill Lynch but that was an opinion which they had and since under s. 195(1), as it stands after the amendment made by the Finance Act, 1987, w.e.f. 1st June, 1987, the assessee-company was more than a "statutory agent" under s. 163, the position was "a fortiori". The section, as it stood before the amendment, exempted agents constituted as such under s. 163 of the Act from **deducting** tax from chargeable payments made to non-residents. This was because they were assessable on behalf of the non-residents and tax could be covered from them pursuant to such assessments. The amendment **deleted** the reference to agents assessed and paying tax as such under s. 163, with the result that every person making payment of chargeable sums to the non-resident became liable to **deduct** tax whether he has been constituted an agent of the non-resident under s. 163 or not.

123. We are of the view that the amendment does not assist the Revenue. Before the amendment, agents appointed under s. 163 were not liable to **deduct** tax from payments in respect of which they would be liable as such agents to pay tax. The exemption has been removed by the amendment, with the result that any person, including an agent appointed under s. 163, is liable to **deduct** tax from payments to non-residents, notwithstanding that he would be liable to **deduct** tax as agent on behalf of the non-resident at a later stage. That only means that even if the **Department** has not treated the assessee-company as agent under s. 163 that cannot **detract** from the liability to **deduct** the tax from payment of chargeable sums to non-residents. Mr. Kapila of course would be quite right if what he meant to convey was that after the amendment in 1987 it is not necessary to treat the assessee-company as an agent under s. 163 in order to fasten the liability upon it to **deduct** tax in respect of all chargeable payments made to a non-resident but that is as far as he can go. That does not provide an effective answer to the contention raised on behalf of assessee that in the absence of a valid notice of **demand** served on the assessee the tax in respect of which he is considered to be in **default** cannot be recovered. In our opinion, the two aspects are different. However, there is no need to examine this aspect further since we have held that the tax can be recovered even in the absence of a **demand** notice, following the Kerala High Court's judgment (supra).

124. We make it clear that no such argument (absence of **demand** notice) was advanced on behalf

of the assessee before us in respect of the interest charged under s. 201(1A). Even with regard to the tax, the argument does not appear to have been taken before the CIT(A). We may, however, add that in the memorandum of appeal (Form No. 35) in respect of both the appeals before the CIT (A), against the column where the assessee is required to state the date of service of the notice of demand, the assessee-company has referred to tax "purportedly demanded from the appellant" and has also stated that no notice of demand has been served on it both in respect of the tax and interest.

125. We, therefore, find this issue against the assessee-company.

Interest under s. 201(1A)—Is the levy proper ?

126. Mr. Dastur took up the contention that the levy of interest was invalid on two grounds : (a) that the assessee-company acted on the bona fide belief that the amount paid to Merrill Lynch was not taxable, and (b) the assessee-company acted honestly on the advice of M/s Skadden, Arps, Slate, Megher & Flom, Solicitors (pp. 71-72 of the Department's paper book No. 1) in not deducting tax, the opinion given by them being that there was first a sale to the lead managers and thereafter a sale by the lead managers to the investing public. He cited the judgment of the Madhya Pradesh High Court in Gwalior Rayon Silk Mills Ltd. vs. CIT (1983) 37 CTR (MP) 351 : (1983) 140 ITR 832 (MP).

127. Mr. Kapila opposed the contention on the ground that the bona fide of the assessee-company was not relevant for deciding the chargeability of the interest. As regards the judgment cited on behalf of the assessee, he pointed out that, that was a case of short-deduction of tax and not a case of total failure to do so. He contended that s. 201(1A) is not a penal provision and that it provided for compensatory interest, the Government having been deprived of the enjoyment of the monies in question. He cited the judgment of the Hon'ble Bombay High Court in Bennett Coleman & Co. Ltd. vs. V.P. Damle, Third ITO (1986) 47 CTR (Bom) 342 : (1986) 157 ITR 812 (Bom) to contend that once default was established the interest is mandatory. He also cited the following judgments :

(i) CIT vs. Dunlop Rubber (1979) 8 CTR (Cal) 110 : (1980) 121 ITR 476 (Cal)

(ii) Grindlays Bank Ltd. vs. CIT (1992) 110 CTR (Cal) 164 : (1993) 200 ITR 441 (Cal)

(iii) Traco Cables (supra)

128. The question of validity of the levy of interest would arise only if the assessee-company is liable to pay the tax. We have held, for various reasons, that the assessee-company was not liable to deduct the tax. The levy of interest would, therefore, be academic.

Grossing up

129. There is no dispute that the assessee-company is to bear the taxes on the amounts paid to Merrill Lynch. Therefore, s. 195A and s. 10(6A) apply, according to which there shall be no grossing up of the taxes if the agreement is approved by the RBI and it is in accordance with the industrial policy declared by the Government. There seems to be no dispute about these aspects. But the CIT (A) has restored the matter to the AO though he thought that on merits the assessee had a good case. We do not feel inclined to interfere.

130. We summarise our conclusions on the substantive issues as follows :

(1) There was no sale of GDRs to the lead managers/managers so that it can be said that they had "resold" them. They did not also "subscribe" to the GDRs. Consequently, it cannot be said that the

amounts paid to them (selling concession/commission, underwriting commission and management commission) or **deducted** by them from the sale proceeds of GDRs represented only sale discount.

(2) The "finished package" theory is also rejected. It cannot be said that the assessee-company obtained a "finished package" (a successfully marketed GDR issue) in return for what was paid to the lead managers/managers. Consequently, what was paid to them cannot be considered as purchase price of the "finished package".

(3) The services rendered by the lead managers/managers in connection with the GDR issue fall within the **definition** of "technical services" under s. 9(1)(vii) of the IT Act, 1961, r/w Expln. 2 thereto. Those services are "managerial" or "consultancy" services. The management commission and selling concession/commission are, therefore, income of the lead managers/managers **deemed** to accrue or arise in India and accordingly, the assessee-company was liable to **deduct** tax under s. 195(1). However, the underwriting services are not "technical" services. Therefore, the underwriting commission does not fall within s. 9(1)(vii), insofar as it relates to the issue of GDRs outside USA. The assessee-company was not, therefore, liable to **deduct** tax therefrom under s. 195(1). As regards the GDRs issued in USA to QIBs, there was no underwriting and, therefore, what was paid as underwriting commission was not in fact so and, therefore, this part of the payment would be income by way of fees for technical services **deemed** to arise or accrue in India within the meaning of s. 9(1)(vii) and accordingly the assessee-company was liable to **deduct** tax therefrom under s. 195(1).

(4) The reimbursement of expenses cannot be considered as taxable in India even under s. 9(1)(vii).

(5) However, the DTAA with UK (1993) is applicable and the payments made do not fall within the **definition** of "fees for technical services" under art. 13.4(c) of the agreement. Hence, they were not taxable in India. Consequently, the assessee-company was not liable to **deduct** tax from them. It cannot, therefore, be treated as an "assessee in **default**" under s. 201. Consequently, no interest under s. 201(1A) can be charged.

131. Our conclusions on other issues, some of which may be academic so far as the present appeals are concerned, are :

(1) Sec. 195(1) does not contemplate, or in other words, there is no necessity for, the passing of an order thereunder.

(2) However, it is necessary to pass an order under s. 201(1) **declaring** the assessee to be "in **default**" and merely because no order under s. 195(1) is contemplated or is necessary it cannot be said that no order can be passed under s. 201(1).

(3) The liability of the assessee-company to **deduct** tax was limited to the income portion hidden or embedded in the payments but for that purpose it ought to have applied to the AO under s. 195(2) for **determination** of the appropriate proportion. In the absence of such an application, the liability extended to the whole payment.

(4) The tax **deductible** under s. 195(1) can be recovered from the assessee-company even without the service of a notice of **demand**.

(5) There was a credit as well as an actual payment to Merrill Lynch under s. 195(1) read with the Explanation thereto.

132. Finally, a word about the arguments addressed before us. It must be placed on record that we had the advantage of well-prepared arguments presented before us by both sides with learning,

precision and clarity.

133. The appeals are allowed as indicated above.

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