# The Commissioner of Income Tax Vs Van Oord ACZ Equipment BV

**Court:** Madras High Court

**Date of Decision:** Nov. 14, 2014

**Acts Referred:** Income Tax Act, 1961 â€" Section 195(2), 2(23A), 4, 44BB, 5

**Citation:** (2015) 273 CTR 548 : (2015) 373 ITR 133 : (2015) 228 TAXMAN 199

**Hon'ble Judges:** R. Sudhakar, J; G.M. Akbar Ali, J

**Bench:** Division Bench

## Judgement

1. The appeal has been filed by the Revenue challenging the order of the Income Tax Appellate Tribunal "A" Bench, Chennai, dated 29.3.2007

made in ITA No. 1894/Mds/2005 for the assessment year 2003-2004.

2. The brief facts of the case are as under: The assessee is a company incorporated in Netherlands and falls within the definition of a foreign

company under Section 2(23A) of the Income Tax Act (for brevity, "the Act"). The management and control of the assessee company is situated

in Netherlands. The assessee during the year 2002-2003 let out dredging equipment to their Indian company, namely, Van Oord ACZ India P.

Ltd. The assessee filed return of income along with a brief note elucidating the provisions of the Double Taxation Avoidance Agreement signed by

the Government of India with the Government of Netherlands and stating that the income earned by letting out of industrial equipment would not be

taxable in India. However, the Assessing Officer held that since the definition of royalty, as enumerated in Section 9 of the Act, means

consideration for use or right to use any industrial, commercial or scientific equipment, the consideration received by the assessee company falls

within the definition of royalty in Section 9 of the Act and accordingly, the same is liable to tax in India.

3. Assailing the assessment order, the assessee filed an appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income

Tax (Appeals) after taking note of:

(i) the documents produced by the assessee from the Income Tax Department of the Netherlands to the effect that equipment rent is included in the

total income of the appellant as per the laws of the Netherlands and tax has also been paid on the same, and

(ii) the amended provisions of the Double Taxation Avoidance Agreement, held that the contracting country (in the present case India) should not

levy income tax on the said income. Accordingly, the Commissioner of Income Tax (Appeals) deleted the tax so imposed by the Assessing

Officer.

4. Aggrieved by the above said order, the Revenue preferred an appeal before the Tribunal. The Tribunal, while confirming the order passed by

the Commissioner of Income Tax (Appeals), observed that when the assessee has no permanent establishment in India, there is no charging

provision in the Act to bring this income under the provisions of the said Act for the purpose of bringing the same to tax.

5. Challenging the above said order, the Revenue has filed this appeal on the following substantial question of law:

Whether, in the facts and circumstances of the case, the Tribunal was right in holding that the amount received by the assessee for hiring out

dredgers to an Indian Company of the same name for use in Indian ports is not taxable in India in terms of the Double Taxation Avoidance

Agreement with the Netherlands?

6. The main contention of the learned Senior Standing Counsel appearing for the Revenue is that as per Clause (iva) to Explanation 2 to Section

9(1) of the Act, the consideration received for the use or right to use, any industrial, commercial or scientific equipment, but not including the

amounts referred to in section 44BB, is royalty and since Section 44BB is not applicable to the case on hand, the income is chargeable to tax in

India.

7. The next contention of the learned Senior Standing Counsel appearing for the Revenue is that as per Article 12(1) of the Double Taxation

Avoidance Agreement, royalty arising in a contracting State may be taxed in the other State and, therefore, there is no restriction on the Revenue

to impose tax in India, solely because the assessee has paid tax in the Netherlands.

8. The learned counsel for the revenue would further submit that the payment made towards chartering of the ship should be considered as

business income and such business income would attract the provisions of the Income tax under Article 7 of the DTAA. He also placed reliance on

Article 5 which defines permanent establishment chargeable to tax in India. The learned counsel relied on M/s. Poompuhar Shipping Corporation

Ltd. Vs. The Income Tax Officer, International Taxation II, and contended that the consideration paid for the use of equipment is liable to be

treated as Royalty as defined in Explanation II to Sec. 9(1)(i) of the Income Tax act.

9. On the other hand, the contention of the learned Senior counsel for the respondent company is as follows:

The respondent company is incorporated in Netherlands and the entire management and control is situated outside India. Therefore, there is no

permanent establishment in India.

The Foreign company was engaged in the business of hiring out of dredging equipment and had let out such dredging equipment to its sister

concern, which is incorporated in India and for such use of equipment, the company has raised invoices and the Indian Company deducted income

tax at source (TDS) for which the foreign company is not liable to, and made a claim for refund.

The amount received by the foreign company is a payment for use of equipment and the foreign company is governed by the provisions of Double

Taxation Avoidance Agreement (DTAA) and according to the amended DTAA, the income earned from hiring of dredging equipment was not

taxable in India.

The payment towards the hire of dredging equipment is not a royalty as defined under Explanation II to clause (iva) to sec. 9(1) of the Act.

The dredging equipment was leased out on bareboat understanding (i.e.) without Master and Crew and therefore it is not a Ship as stated by the

Department. Therefore, the decision rendered in M/s. Poompuhar Shipping Corporation Ltd. Vs. The Income Tax Officer, International Taxation

II, is not applicable.

As per the decision rendered in the case of Union of India and Another Vs. Azadi Bachao Andolan and Another, , if a tax liability is imposed by

the Income Tax Act, the provisions of the DTAA agreement would prevail over the provisions of the Income Tax Act and therefore, there is no tax

liability on the foreign company.

In similar cases involving Netherlands Companies doing business in India, the High Court of Uttarakhand and the High Court of Calcutta had

clearly held under Article 5 of the DTAA agreement between India and Netherlands, the Netherlands companies are not permanent establishment

in India and therefore, there is no tax liability. Reliance was also placed in the case of ABN Amro Bank, N.V. Vs. Commissioner of Income Tax

and Another, and also in the case of The Commissioner of Income Tax Dehradun And another Vs. M/s BKI/HAM v.o.f. C/o Arthur Anderson

and Co., New Delhi, .

10. Heard both sides and perused the materials available on record.

11. The following facts are not disputed:

The respondent is a Company incorporated in Netherlands and had let out dredging equipments to one of its sister concerns which is a company

incorporated in India for the purpose of dredging as per the contract awarded by Gujarat Adhani Port Limited. The respondent company raised

invoices for the use of the equipment from 1.7.2001 to 31.3.2003 amounting to Rs.18,87,40,695/-. The Indian Company deducted TDS of

Rs.5,49,04,367/- under section 195(2) of the Act. The respondent company filed its return claiming the entire TDS amount by way of refund

stating that they are not liable for Tax under the provisions of DTAA agreement. However, the assessing officer found that w.e.f. 1.4.2002, any

consideration for the use or right to use any industrial, commercial or scientific equipment are included in the term ''Royalty'' by the amending clause

in Explanation to (iva) to sec. 9(i) of the Act and held that the consideration received by the appellant was taxable and levied income tax at the rate

of 10% on the amount of Royalty.

12. On appeal, the Commissioner of Income Tax (Appeals) considered the DTAA agreement and also the modified provisions of Article 12 of the

DTAA agreement where the definition to Royalty was modified and the words ''payments of any kind received as consideration for the use of or

the right to use industrial, commercial or scientific equipment'' were deleted from the definition. Therefore, the appellate authority deleted the levy

of tax at 10% on equipment rent earned by the respondent company.

13. On further appeal by the Department, the Tribunal has also accepted that the respondent Company is not liable for Tax as per the provisions

of the DTAA Agreement and also held that there is no permanent establishment in India to bring the income under the provisions of the Income

Tax Act.

14. Before adverting to the merits of the case it is necessary to deal with the Double Taxation Avoidance Agreement which is known as DTAA.

Under a Notification No. GSR 382(E) DATED 27.3.1989, the convention, between the Government of Republic of India and the Kingdom of

Netherlands for the Avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, came into

force w.e.f. 21.1.1989. Both Governments have agreed and the DTAA agreement with seven chapters and 30 Articles was signed. A protocol

with additional article was also signed. The definitions under Article 3 (a) defines the State and States, which read as follows:

(a) the term State means the Netherlands or India, as the context requires, the term States means the Netherlands and India;

15. Article 5 deals with permanent establishment sub clauses 1 and 2 are as follows:

1. For the purposes of this Convention, the term permanent establishment means a fixed place of business through which the business of the

enterprise is wholly or partly carried on.

2. The term permanent establishment includes especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a premises used as a sales outlet;

(i) an installation or structure used for the exploration of natural resources provided that the activities continue for more than 183 days.

16. Article 7 deals with business profits. Article 12 deals with Royalties, fees for technical service and payments for the use of equipment.

Originally, sub clause (1) to (4) of Article 12 stood as follows:

1. Royalties, fees for technical services and payments for the use of equipment arising in one of the States and paid to a resident of the other State

may be taxed in that other State.

2. However, such royalties, fees and payments may also be taxed in the state in which they arise and according to the laws of that State, but if the

recipient is the beneficial owner of these categories of income, the tax so charged shall not exceed 20 per cent of the gross amount of the royalties,

of the fees and payments.

3. The competent authorities of the States shall by mutual agreement settle the mode of application of paragraph 2

4. The term royalties as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any

copyright of literary, artistic or scientific work, including motion picture films and works on film or video tape for use in connection with television,

any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific

experience.

(emphasis supplied)

17. Subsequently, there was an amendment w.e.f. 1.4.1991 and sub clauses (1), (2) and (4) of Article 12 were modified as follows:

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that

other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws

of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged

shall not exceed.

(a) in the case of royalties referred to in sub-paragraph (1) of paragraph 4 and fees for technical services as defined in this Article (other than

services described in sub-paragraph(b) of this paragraph);

(A) 15 percent of the gross amount of the royalties or fees for technical services as defined in this Article, where the payer of the royalties or fees is

the Government of that Contracting State, a Political sub-division or a public sector company; and

(B) 20 per cent of gross amount of the royalties or fees for technical services in all other cases; and

(ii) during the subsequent years, 15 percent of the gross amount of royalties or fees for technical services; and

(b) in the case of royalties referred to in sub-paragraph(b) of paragraph 4 and fees for technical services as defined in this Article that are ancillary

and subsidiary to the enjoyment of the property for which payment is received under paragraph 4(b) of this Article, 10 percent of the gross amount

of the royalties or fees for technical services.

4. The term royalties as used in this Article means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright to literary, artistic or scientific work including

motion picture films and works or videotape for use in connection with television, any patent, trade mark, design or model, plan, secret formula or

process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, for the right to use industrial, commercial or scientific equipment, other than

payments derived by an enterprise described in paragraph 1 of Articles 8 and 8A (Shipping and Air Transport) from activities described in

paragraph 2(a) of Article 8 or paragraph 4(b) of Article 8A.

18. In a further modification w.e.f. 1.4.1997, sub clause 2 was modified as follows:

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws

of that State, but if the recipient is the beneficial owner of the royalties, or fees for technical services, the tax so charged shall not exceed 10

percent of the gross amount of the royalties or the fees for technical services.

19. W.e.f. 1.4.1998, sub clause 4 of Article 12 was also modified as follows:

4). The term royalties as used in this Article means payment of any kind received as a consideration for the use of, or the right to use, any copyright

to literary, artistic or scientific work including cinematograpy films, any patent, trade mark, design or model, plan, secret formula or process, or for

information concerning industrial, commercial or scientific expression.

20. Clause (1) of Article 12 originally covered "Royalties", "fees for technical services" and "payments for the use of equipments". A plain reading

would show that if any one of the above category arises in one of the "States" viz., Netherlands and India and paid to a resident of the other

"State" i.e., Netherlands or India, the same may be taxed in that other "state" i.e., Netherlands or India.

21. Clause (2) however stated that such royalties, fees, payments may also be taxed in the State in which they arise and according to the laws of

the State. But the tax so charged shall not exceed 20% of the gross amount.

22. Sub clause (4) defines royalties which will include any consideration received for the use of any copy right of literary, artistic or scientific work

including motion picture films and works on film or video tape for use in connection with television, any patent, trade mark, design or model, plan,

secret formula or process, or for information concerning industrial, commercial or scientific experience.

23. Clause 5 defines "fees for technical services" and clause (6) defines the term "payments for the use of equipment" and means payment of any

kind received as a consideration for the use of or the right to use industrial, commercial or scientific equipment.

24. However, clause (1) of Article 12 as modified w.e.f. 1.4.1991 would show that the "Royalties" and "fees for technical services" arising in a

Contracting State and paid to the resident of the other Contracting State may be taxed in that other State. In this modification, the category

"payments for the use of equipment" does not figure.

25. Coming to the modification to clause 2, the first part of Clause 2 is similar to the earlier clause 2, however, the method of tax so charged is

divided into two categories with reference to the modified (a) and (b) of clause 4. However, clause(2) was again modified w.e.f. 1.4.1997 to its

original position with a slight change of "tax so charged shall not exceed 10%" as against the original 20%. Similarly, w.e.f. 1.4.1998, clause 4 was

also restored its original position deleting sub clause (a) and (b).

26. In the modification w.e.f. 1.4.1991, clause 6 the definition for payments for the use of equipments did not figure. Clause 5 defines fees for

technical services and clause 6 defines the amount which does not include for fees for technical services. The above said clause 6 was further

modified w.e.f. 1.4.1995.

27. Sub clause (b) of clause 4 as modified w.e.f. 1.4.1991 defined payments of any kind received as consideration for the use of, for the right to

use industrial, commercial and scientific equipment, thereby literally including the category "payments for the use of equipment" into the category of

Royalties. However, clause 4 to Article 12 was restored to original position w.ef.1.4.1998.

28. The above would show that for all practical purposes, the "payments for the use of equipment" originally found in clause (1) of Article 12 as

defined in clause (6) was incorporated in the definition of the term Royalties in clause 4 w.e.f. 1.4.1991 and subsequently deleted w.e.f. 1.4.1998

and thereby completely taken out from clause (1) and (2) of Article 12. This means that the payment for the use of equipment or any consideration

for the use of , for the right to use industrial, commercial or scientific equipment is deleted and it is not taxable in the contracting State in which they

arise viz., in the given case India.

29. Sec. 90 of the Income Tax Act 1961 enables and empowers the Central Government to issue Notification for implementation of the terms of

Double Taxation Avoidance Agreement. In Union of India and Another Vs. Azadi Bachao Andolan and Another, , the Hon"ble Supreme Court

considered Sec. 90 of the Act and held as follows:

No provision of the Double Taxation Avoidance Agreement can possibly fasten a tax liability where the liability is not imposed by the Act. If a tax

liability is imposed by the Act, the Agreement may be resorted to for negativing or reducing it; and, in case of difference between the provisions of

the Act and the Agreement, the provisions of the Agreement would prevail over the provisions of the Act and can be enforced by the appellate

authorities and the court.

Section 90 is specifically intended to enable and empower the Central Government, to issue notification for implementation of the terms of a

Double Taxation Avoidance Agreement. The provisions of such an Agreement, with respect to cases to which they apply, would operate even if

inconsistent with the provisions of the Income-Tax Act. If it was not the intention of the Legislature to make a departure from the general principles

of chargeability to tax under section 4 and the general principle of ascertainment of taxable income under section 5, then there was no purpose in

making those sections subject to the provisions of the Act.

Section 90 was brought into the statute book precisely to enable the executive to negotiate a Double Taxation Avoidance Agreement and quickly

implement it. Even accepting that the powers exercised by the Central Government under section 90 are delegated powers of legislation, there is

no reason why a delegatee of legislative power, in all cases, has no power to grant exemption. The delegate of a legislative power can exercise the

power of exemption in a fiscal statute.

When the requisite notification has been issued under section 90, the provisions of sub-section (2) of section 90 spring into operation and an

assessee who is covered by the provisions of the Double Taxation Avoidance Agreement is entitled to seek the benefits thereunder, even if the

provisions of the Double Taxation Avoidance Agreement are inconsistent with those of the Act.

Therefore, a Notification No. S4693(E) dated 30.8.1999 was issued under Sec. 90 of the Income Tax Act bringing in the above said

modification, as India and Netherlands are members of the Organisation for Economic Co-operation and Development (OECD) to limit the

taxation in line with the conventions between India and other countries. Therefore the provisions of the Agreement would prevail over the

provisions of the Act.

30. Clause (iva) of Sec. 9(1) of Income Tax Act defines Royalties. w.e.f. 1.4.2002. But, in our considered view, Clause (iva) of Sec. 9(1) is not

applicable for the simple reason that the payments for the use of equipment was no longer taxable in the Contracting State viz., India after the

modification dated 1.4.1998 in the DTAA.

31. The learned Standing counsel for the department would rely upon the judgment rendered in the case of M/s. Poompuhar Shipping Corporation

Ltd. Vs. The Income Tax Officer, International Taxation II, . The main question before the Division Bench in the above decision was whether the

payment made for taking ship on time charted basis would constitute Royalty as defined under Sec. 9(1)(vi)(b) of the Income Tax Act.

32. The DTAA of Australia, USA, France, Germany, Norway, Singapore and Switzerland were considered and particularly, Art.12 (3) which

defined the term Royalties was under consideration. The said Art. 12(3) is pari materia to Art.12(4) as modified w.e.f. 1.4.1991 of DTAA with

Netherlands.

33. For better appreciation, paragraphs 88 to 92 in the case of Poompuhar Shipping corporation case (cited supra) are reproduced hereunder:

88. This takes us to the consideration on Article 12 under DTAA. Article 12 of the Australian DTAA deals with the jurisdiction of and the State on

the taxability of royalty. It states that Article 8 "Ships and aircraft" 1. Profits from the operation of ships or aircraft, including interest on funds

connected with that operation, derived by a resident of one of the Contracting States shall be taxable only in that State. The definition of royalty as

given under article 12(3) of the DTAA with Australia is the same as in the definition in the DTAA with France in Article 13, with Germany in

Article 12; with Norway in Article 13; with Singapore in Article 12; with Switzerland in Article 12 and with U.S.A in Article 12.

89. The U.S.A DTAA specifically reads that royalty would mean payments of any kind, as follows:

12. Royalties and fees for included services:- (1) Royalties and fees for included services arising in a Contracting State and paid to a resident of the

other Contracting State may be taxed in that other State....

(3) The term royalties as used in this article means

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work,

including cinematography films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting,

any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific

experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition

thereof; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment, other than

payments derived by an enterprise described in paragraph (1) of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c)

or 3 of Article 8.

90. Thus, while some of the DTAAs include payment for use of or right to use of industrial, commercial and scientific experience as a heading

under royalty, invariably, in all the DTAAs payment for use of or right to use of industrial, commercial and scientific equipment, is included in the

meaning of royalty. The provision contained in section 9(1)(vi), Explanation 2 (iva) is modelled after U.N. Model and is different from what one

has in the OECD model at present.

91. Thus, while the OECD Model got amended to bring payment for use of or right to use of the industrial, commercial scientific experience as

royalty, all the DTAA s under consideration contain the clauses on consideration for use of or right to use of industrial, commercial and scientific

equipment as well as experience as royalty.

92. Thus, when the use or right to use the ship for an economic benefit is given to the assessee, the consideration for the use of the industrial,

commercial and scientific equipment is royalty, assessable under Explanation 2(iva) to section 9(1)(vi) of the Income Tax Act. Thus, for the

purposes of Income Tax Act, under the time charter, the payment made being for the use of the ship, the same comes within the meaning of the

word royalty.

34. While considering the DTAA that is applicable to the present case and the DTAA that was considered in Poompuhar Shipping case, referred

supra, we find that the amendment to Clause 4 of Article 12 with effect from 1.4.1998 by deleting the term "payments for the use of the

equipment" from the definition of royalties makes the present case distinguishable on facts. In Poompuhar Shipping case, referred supra, it was a

case of hiring of ship on time-charter basis, whereas in the present case, dredging equipment is leased out on bareboat basis, namely, without

Master and Crew. Therefore, on facts, the decision in Poompuhar Shipping case, referred supra, is distinguishable.

35. The learned Standing Counsel for the department referring to paragraph (2) of Article 5 which states that an installation or structure used for

the exploration of natural resources is a permanent establishment, provided that the activities continue for more than 183 days, pleaded that the

stand of the department is justified.

36. We are not inclined to accept such a plea, as in the case on hand the dredging equipment was leased out on bareboat basis viz., without

Master and Crew. Therefore, it will not come under the permanent establishment and the entire control over the equipment was not with the

Foreign company, but with the Indian Company. Therefore, the above said plea is not accepted.

37. For the foregoing reasons, the appellate authority below has rightly considered Article 12(4) of the DTAA agreement between Netherlands

and India and is right in holding that the amount received by the assessee for hiring out Dredgers to an Indian Company of the same name for use in

Indian Ports is not taxable in India and the substantial question of law is answered against the Revenue/appellant.

38. In the result, the appeal is dismissed and order of the Income Tax Appellate Tribunal Chennai "A" Bench, dated 29.3.2007 made in ITA No.

1894/Mds/2005 for the assessment year 2003-2004 is confirmed. No costs.