Commissioner of Income Tax Vs Hindusthan Paper Corpn. Ltd.

Court: Calcutta High Court

Date of Decision: Feb. 23, 1994

Acts Referred: Income Tax Act, 1961 â€" Section 195(2), 256(1), 9, 9(1)(vi), 9(1)(vii)

Citation: (1994) 77 TAXMAN 450

Hon'ble Judges: Bhagabati Prasad Banerjee, J; Ajit K. Sengupta, J

Bench: Division Bench

Judgement

Ajit K. Sengupta, J.
In this reference u/s 256(1) of the income tax Act, 1961 ("the Act") at the instance of the revenue, the following

questions have been referred by the Tribunal for the opinion of this Court:

1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in considering that the consideration of French Franc

2,70,000 was from Engineering or Commercial activity of the nonresident company Kerbs & CIE, S.A., Paris, France?

2. Whether, the Tribunal was justified in arriving at conclusions as mentioned in question No. 1 above without going into the express provisions in

Explanation appended to section 9(1)(vii) of the income tax Act, 1961 which defines technical services?

The facts giving rise to this reference as summarised by the Tribunal are as under:

This reference relates to an agreement entered into by the assessee-company with Kerbs & CIE, S.A., Paris, France on 29-10-1981 for setting

up a plant for the production of Caustic Soda Chlorine and Chloride -Chlorine Dioxide at Nowgang Paper Project. The assessee-company made

an application to the ITO on 30-6-1982 for ascertaining the rate of tax which could be deducted at source by the assessee-company on the

remittance of French Franc 2,70,000 to the French firm. The ITO passed an order on 8-7-1982 u/s 195(2) of the Act, directing the assessee-

company to deduct tax at the rate of 20 per cent on the 50 per cent of French Franc 2,70,000 and at the rate of 40 per cent on the balance 50 per

cent of French Franc 2,70,000. It was also directed that the tax should be calculated on tax basis as the assessee-company was required to remit

French Franc 2,70,000 net of Indian tax.

2. Clause II of the said agreement executed between the assessee- company and the said French firm deals with the scope of work. The French

firm being the vendor under the said agreement agreed to provide and the assessee-company being the purchaser agreed to avail of it and buy the

following:

(a) Know-how and basic engineering services for Chlorate-Chlorine Dioxide section of the plant;

(b) Machinery and equipment of imported origin for both Chloride- Chlorine Dioxide and Caustic Soda Chlorine section of the plants;

(c) Supervision; erection and commissioning of the said two plants;

(d) Training of technical personnel of the assessee-company for Chlorate- Chlorine Dioxide section of the plant.

The total consideration payable by the Indian company to the French firm in respect of all the aforesaid matters was stated under Clause IV to be

French Franc 11,372,000 and Swiss Franc 2,148,500. The remittance of French Franc 2,70,000 in respect of which the said order dated 8-7-

1982 was passed u/s 195(2) was in fact the first instalment of the total consideration as aforesaid as stipulated in the said agreement.

3. A Double Taxation Avoidance Agreement (DTA) exists between the Government of India and the Government of French Republic. This

agreement is dated 26-3-1969. Article III(1) of the said agreement clearly provides that the industrial or commercial profits (excluding the profits

derived from the operation of ships or aircrafts) of an enterprise of one of the contracting States shall not be subjected to tax in the other

contracting States unless the enterprise has a permanent establishment situated in that other contracting State. If it has such a permanent

establishment, the profits attributable thereof shall be subjected to tax only in that other contracting State. Article 111(5) further provides that the

term "industrial or commercial profits" as used in this article shall not include income in the form of dividends, interests, rents, royalties and similar

payments as referred to in paragraph (2) of article VII, capital gains, remuneration for personal services or fees for technical services. The term

"permanent establishment" is defined in article II(i) of the said agreement to mean a fixed place of business in which the business of the enterprise is

wholly or partly carried on. The term "fixed place of business" shall include a place of management, a branch, an office, a factory, a workshop, a

warehouse, a mine, a quarry or other places of extraction of natural resources.

4. Article VII(1) of the said DTA further provides that royalties derived by a resident of one of the contracting States from sources in the other

contracting States may be taxed in both the contracting States. Article VII(2) defines the term "royalties" to mean payments of any kind received

as consideration for the use of, or for the right to use any copyrights of literary, artistic or scientific works, cinematographic films, patents, models,

designs, plans, secret process or formulae, trademarks or for the use of, or for the right to use, industrial, commercial or scientific equipment or for

information concerning industrial, commercial or scientific experience, but does not include any royalty or similar payments in respect of the

operation of mines, quarries or other places of extraction of natural resources.

The question involved in this reference is whether the consideration received by the French firm for the supply of various technical know-how and

basic engineering services as also for supply of imported equipments constitutes industrial or commercial profits within the meaning of article

111(5) of the DTA agreement between the Government of India and the Government of France.

5. The Commissioner (Appeals) looked into the terms of agreement executed on 29-10-1981 between the assessee-company and the French firm

and after examining the DTA, the Commissioner (Appeals) felt that the profits arising, if any, to the French firm under the said agreement were

clearly "Industrial or commercial profits" within the meaning of article 111(5) of the DTA. He, therefore, felt that the assessee-company was not

required to deduct any tax at source before making remittance to the French firm since such industrial or commercial profits, if any, derived by the

French firm under the said Agreement were liable to be taxed only in France and not in India in view of the specific provisions contained in article

111(1) of the DTA as aforesaid.

6. On appeal by the revenue, the Tribunal also examined the said agreement dated 29-10-1981 entered into between the assessee-company and

the said French firm and after considering the provisions of the DTA, the Tribunal felt that the said agreement provided for supply of setting up of a

plant with the engineering services of the French party. The enterprise taken by the French party in supplying and setting up the plant with its

engineering services was nothing but to derive the profits which come within the purview of "industrial or commercial profit". As defined in article

111(5) of the DTA and, therefore, according to the Tribunal, no tax was payable by the French firm. The Tribunal also considered the alternative

argument of the departmental representative to the effect that the definition of royalty, as contained in section 9 of the Act, should also be

considered. The Tribunal felt that since royalty has also been defined in DTA itself, there was no need to go to the definition of royalty as contained

in section 9. After considering the definition of royalty as contained in article VII(2) of the DTA, the Tribunal felt that the total consideration

payable by the assessee-company to the French firm was not for use of or right to use, the patents, designs, secret process or formulae, etc., as

contemplated under article VII(2) of the DTA. In that view of the matter, the Tribunal held that no tax was payable by the French firm and,

therefore, there was no question of deducting any tax at source either at the rate of 20 per cent or at the rate of 40 per cent as originally directed

by the ITO in his order dated 8-7-1982 passed u/s 195(2).

7. The learned counsel appearing for the revenue before us submitted that the Tribunal misconstrued the provisions of article III and article VII(2)

of the DTA and it failed to consider the definition of royalty and technical service fees as contained in section 9. According to him, the total

payments made by the assessee-company for know-how and basic engineering services came within the expression ''royalty'' as defined under

article VII of the DTA and, therefore, it was wholly taxable in this country. He submitted that the payments made to the French firm did not come

within the expression ''industrial or commercial profits'' as defined in article 111(5) of the DTA. The learned counsel appearing for the revenue also

submitted that it is necessary to consider the definition of royalties as contained in section 9 in addition to the definition contained in DTA.

8. Dr. Pal, the learned counsel, appearing for the assessee, however, reiterated the submissions made before the Commissioner (Appeals) as well

as before the Tribunal. He, therefore, submitted that the non resident French firm in this case has agreed to supply the imported equipments as also

the know-how and basic engineering services on an outright basis to the assessee-company in terms of the said agreement executed on 29-10-

1981. The property right in such know-how and basic engineering services has not been retained by the vendor, namely, the non-resident French

firm. In case of royalty, the vendor retains the right of property over the know-how and the basic engineering services but allows the vendor to use

or utilise them and, therefore, what is paid for the use of the know-how and basic engineering services is royalty. In the present case, however,

according to the learned counsel for the assessee, the know-how and basic engineering services were sold out by the French firm to the assessee-

company on outright sale basis and the French firm, the vendor, did not retain any property or other right over the same. It was further submitted

by Dr. Pal that there was no provision in the agreement for limiting the use of the rights for a certain period nor the assessee-company was given an

exclusive right to use the know-how for a limited period. This was so because it was a case of sale on outright basis in terms of the said agreement.

He, therefore, submitted that the Tribunal was fully justified in holding that no part of the consideration payable by the Indian company, the

assessee-company, to the French firm was chargeable to tax in India.

9. At the outset we may deal with the alternative argument raised before us by the learned counsel appearing for the revenue to the effect that the

Court should also look into the definition of royalty as contained in Explanation 2 to section 9(1)(vi). It is by now well-settled that wherever there is

a conflict between a DTA and the specific provisions contained in the income tax Act, the provisions of DTA will prevail over the statutory

provisions contained in the said Act. In this connection reference may be made to Circular No. 333, dated 2-4-1982 - [1982] 137 ITR (St.) 1.

The CBDT made it quite clear that where a specific provision is made in the DTA, that provisions will prevail over the general provisions contained

in the Act. In fact, the DTA which has been entered into by the Central Government u/s 90 of the Act, also provides that the laws in force in a

country will continue to govern the assessment and taxation of income in that country except where provisions to the contrary had been made in the

agreement. Thus, where a DTA provides for a particular mode of computation of income, the same should be followed irrespective of the

provisions in the Act. Where there is no specific provision in the agreement, it is the basic law, ie., the Act, that will govern the taxation of income.

10. We also find that sub-section (2) has been inserted in section 90 of the income tax Act, by the Finance (No. 2) Act, 1991 with retrospective

effect from 1-4-1992. Sub-section (2) so inserted as aforesaid clearly provides that where the Central Government has entered into an agreement

with the Government of any country outside India u/s 90 for granting relief of tax or, as the case may be, avoidance of double taxation, then, in

relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that

assessee.

11. In other words, it is very clear that the DTA Agreement shall always prevail even when an anomaly is noticed between the provisions of the

Act and the provisions of DTA. Further, in view of sub-section (2) of section 90, the assessee has an option to claim that provisions of the Act

may be made applicable if these are more beneficial to the assessee. In other words, the provisions of the Act, which are against the assessee can

never be made applicable. In these circumstances, it is not at all necessary for us to look into the definition of royalty as contained in Explanation 2

to section 9(1)(vi), since it is common ground that the issue in question is covered by the DTA.

Both the Commissioner (Appeals) as well as the Tribunal have looked into the agreement dated 29-10-1981 executed between the assessee-

company and the French firm. These two tax authorities have also examined the provisions of the DTA and more particularly the definition of the

expression "permanent establishment" as contained in article 2 (i), the provisions of article III which deal with the industrial or commercial profits

that have to be taxed as well as article VII which contains the definition of the expression "royalties" and which lays down that royalties derived by

a resident of one of the contracting States from sources in the other contracting States may be taxed in both the contracting States. If the

consideration payable by the assessee-company can come within the expression "royalty" as defined in article VII(2) of the DTA, there is no

difficulty in holding that such royalty can be taxed in India. But in this case, the nature of know-how and basic engineering services as well as

supply of imported equipments to the French firm, supervision, erection and commissioning, including training of technical personnel to be carried

out by the French firm, seem to suggest that this comes within the purview of industrial or commercial profits, and not within the purview of the

expression "royalties" as defined in article VII(2) of the DTA. It is not a case of payment of consideration by the Indian company for the use of or

for the right to use any patent, models, designs, plans, secret process or formulae or for the use of or for the right to use industrial, commercial or

scientific equipments or for information concerning industrial, commercial or scientific experience.

12. We, however, find that one of the stipulations under DTA between the Government of India and the Government of French Republic was to

the effect that where a resident of one of the contracting States fulfils an order for sale of machinery to a resident of other contracting State and it is

incidental to the sale of the machinery that a person or persons employed by the resident of the first-mentioned contracting States should proceed

to the other contracting States although assisting in the installation of the machinery therein, such activity, shall not be deemed to constitute a

permanent establishment unless it is carried on for a period exceeding 3 years or the expenses incurred on such activity are more than 10 per cent

of the total sale price of the order. Sub-clause (bb) of clause (i) of article II(1) of the DTA further lays down that an enterprise of one of the

contracting States shall be deemed to have a fixed place of business in the other contracting States, if it carries out in the other contracting State a

construction, installation or assembly project or the like. In that event it will be a case of permanent establishment within the meaning of article 2(1)

(i). In that case some tax liability will arise in the hands of the French firm in respect of the amount payable by the assessee-company and such tax

liability will have to be determined having regard to the provisions contained in clauses (2), (3) and (4) of article III of the DTA. A perusal of the

scope of technical and engineering services to be provided by the French firm to the assessee-company shows that the French firm will also assist

the Indian company in the installation of the plants being sold by them to the assessee-company. This part of the matter has not been considered

either by the Commissioner (Appeals) or by the Tribunal. In our view, this aspect requires consideration. We, therefore, decline to answer the

questions referred to us and remand the matter to the Tribunal and direct it to consider this aspect of the matter as well. Both the assessee as well

as the revenue shall be entitled to place facts as may be considered necessary by the Tribunal for considering this aspect of the matter. The

Tribunal will re-decide the matter afresh in the light of the observation made by us in this judgment.

Bhagabati Prasad Banerjee, J.

I agree.