

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 14.11.2014

CORAM

THE HON'BLE MR.JUSTICE R.SUDHAKAR
AND
THE HON'BLE MR.JUSTICE G.M.AKBAR ALI

T.C.(A).No.1202 of 2007

The Commissioner of Income Tax
Chennai.

.. Appellant

Vs.

Van Oord ACZ Equipment BV
C/o.Deshpande & Mahatme
Chartered Accountants
Gambar Apts, Vasco-Da-Gama
Goa – 403 802.

.. Respondent

Appeal under Section 260A of the Income Tax Act, 1961 against the 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.

For Appellant : Mr.T.Ravikumar
Senior Standing Counsel

For Respondent : Mr.Porus Kaka
Senior Counsel
for Mr.R.Sivaraman

J U D G M E N T

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 2014 360 ITR 257 Madras (Poompuhar Shipping Corporation Ltd. and another vs Income Tax Officer, International taxation) 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 Poompuhar Shipping Corporation Ltd vs Income Tax Officer, International Taxation reported in 2014 360.

ITR 257 Madras is not applicable.

- As per the decision rendered in the case of Union of India and another vs Azadi Bachao Andolan and reported in 2003 263 ITR 706 SC , 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 Uttarkhand 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 reported in 2012 343 ITR 0081 and also in the case of Commissioner of Income Tax vs. BKI/HAM v.o.f reported in 2012 347 ITR 0570.

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 advertng 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 cinematography 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.e.f.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 reported in *2003 263 ITR 706 SC*, 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 negating 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 Poompuhar Shipping corporation Ltd and another vs Income Tax Officer (International Taxation) reported in 2014 360 ITR 257 (Mad). The main question before the Division Bench in the above decision was whether the payment made for taking ship on time chartered 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 DTAA s include payment for use of or right to use of industrial, commercial and scientific experience as a heading under royalty, invariably, in all the DTAA s 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

(27)

is confirmed. No costs.

(R.S.J.,) (G.M.A.J.,)
-11-2014

Index : Yes
Internet : Yes

sr/sasi

(28)

R. SUDHAKAR,J.,
and
G.M.AKBAR

ALI,J.,

sr/sasi

in TC (A) No.1202 of
2007

14-11-2014