

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 20.2.2017

C O R A M

THE HON'BLE MR. **HULUVADI G. RAMESH, ACTING CHIEF JUSTICE**

AND

THE HON'BLE Dr. **JUSTICE ANITA SUMANTH**

Tax Case (Appeal) No.585 of 2008

M/s.Datasoftware Research Co. P. Ltd.,
Kasturi Towers,
6, Smith Road, Chennai 600 002.

... Appellant

VS

The Income Tax Officer (OSD),
Company Circle I(4), Chennai 600 034.

... Respondent

Prayer:- Appeal filed under Section 260A of the Income Tax, 1961, against the Order of the Income Tax Appellate Tribunal, Chennai A Bench, dated 27.11.2007, in I.T.A.No.2072/Mds/2006.

For Appellant : Mr.R.Vijayaraghavan for
M/s.Subbaraya Aiyar

For Respondent : Mr.T.Ravikumar

JUDGMENT

(Judgment of the Court was delivered by Dr.Anita Sumanth, J.)

The appellant is a Company engaged in the business of Data Processing and Software Development/Consultancy and has a branch office

in USA. In respect of assessment year 2003-2004, the profit and loss account of the Appellant reflected the profits relating to domestic business as well as business of the branch. In the computation of income tax, the assessee reduced the profits earned overseas, of an amount of Rs.17,55,796/-, from the taxable profits since the same had been offered to tax in USA. The assessing officer did not agree with the stand of the assessee and accordingly, the assessment in terms of the Income tax Act 1961 (in short 'Act') was completed adding back the entire profits of the branch at USA vide order of assessment dated 24.01.06.

2. The Commissioner of Taxes (Appeals) accepted the stand of the assessee, vide order dated 12.7.2006, that the business profits of the branch at USA had suffered tax in USA and should thus be excluded from the purview of taxation in India as in the alternate the same income would be subject to double taxation.

3. In an appeal filed by the Revenue before the Income Tax Appellate Tribunal (in short 'Tribunal'), the order of the Commissioner of Tax (Appeal) was reversed and that of the assessing officer restored.

4. The Tribunal considers the provisions of Article 7 of the Double Taxation Avoidance Agreement (in short 'DTAA') between India and the United States of America in terms of which the profits of an Assessee shall be liable to tax in India unless the Assessee carries on business in the US through a permanent establishment (in short 'PE') situated therein. Since the branch at USA constitutes a PE, the Tribunal observes that the profits are liable to be brought to tax in USA only. Notwithstanding this position, the Tribunal concludes that the branch profits are not exempt from taxation in India and accordingly tax credit as set out in Article 25.2 of the DTAA would be the only method for the elimination of double taxation.

5. Challenging this conclusion of the Tribunal, the Assessee is in appeal before us with the present appeal raising the following substantial questions of law for adjudication:

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the profits of the branch office/permanent establishment of the assessee established in USA is taxable in India?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that Double Taxation Avoidance Agreement between India and USA does not exempt any income from taxation in India but only permits credit for tax paid in USA?'

6. We have heard the submissions of Mr.R.Vijayaraghavan, learned counsel appearing for the appellant and Mr.T.Ravikumar, learned Standing counsel appearing for the respondent.

7. The assessee is, no doubt, liable to tax on global income in line with the provisions of section 5 of the Act. The profits of the domestic business as well as the branch at USA are duly reflected in the profit and loss account of the assessee. However, when it comes to the computation of taxable income, the provisions of the Act and DTAA both, have to be taken into account to determine the same. The assessee has excluded the branch profits from the computation of taxable income in India by application of the provisions of Article 7 of the DTAA between India and USA. Article 7 of the DTAA reads as under:

The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a)that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c)other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.

Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment

situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

8. There is no dispute that the amount of Rs.17,55,796/- is liable to tax only in USA. According to the Revenue, the only method to eliminate double taxation is the tax credit method as set out under Article 25.2 of the DTAA whereby credit would be given to the tax paid in USA on the branch profits to be set off against the tax liability computed in India. The assessee would however argue that the branch profits are to stand excluded from taxation in India altogether.

9. Article 25 of the DTAA deals with relief from double taxation and reads as under:

ARTICLE 25

RELIEF FROM DOUBLE TAXATION

1.

2. (a) *Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.*

(b)

3. *For the purposes of allowing relief from double taxation pursuant to this article, income shall be deemed to arise as follows:*

(a) *income derived by a resident of a Contracting State which may be taxed in the other state in accordance with this Convention (other than solely by reason of citizenship in accordance 3 of article 1 (General Scope) shall be deemed to arise in that other State;*

(b) *income derived by a resident of a Contracting State which may not be taxed in the other state in accordance with the Convention shall be deemed to arise in the first mentioned State.*

10. According to the Revenue, only the tax credit method would come into play in the present situation as a measure to avoid double taxation. This submission does not take into account the provisions of Article 25.3 that provide an alternate methodology for this purpose. Article 25.3, for the purpose of determining where the income arises, carves out two categories of income, one that '*may be taxed in the other state*', and the other that '*may not be taxed in the other state*'. The treatment in either case is different. In the first case, where income may be taxed in USA, the

income shall be deemed to arise for the purpose of taxation in that state i.e. USA and where the income may not be taxed in USA, the income shall be deemed to arise in India.

11. The provisions of section 5 of the Act dealing with the Scope of Total Income read thus:

'5 (1) *Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which –*

- (a) is received or is deemed to be received in India in such year by or on behalf of such person; or*
- (b) accrues or arises to him in India during such year;*
- (c) accrues or arises to him outside India during such year:'*

12. In terms of Article 25.3 of the DTAA between India and USA, income that, according to the Convention may be taxed in USA would be deemed to arise only in USA. The provisions of Section 5 of domestic law stipulate that the scope of total income under the Act would extend only to such income as has arisen in India. On a combined reading of the two provisions, it is clear that the income that has arisen in USA by virtue of Article 25.3 would stand excluded from the scope of total income for the purposes of the computation of income under domestic law.

13. In conclusion, the provisions of Article 25 contain two methodologies for determination of relief from double taxation - by means of grant of tax credit or by way of exclusion of the income per se. In the present case, the Assessee has, in line with the determination of income as prescribed under section 5 of the Act read with the provisions of Article 25.3 of the DTAA, excluded the branch profits from the computation of its total income. We see no error in the methodology adopted. The order of the Tribunal is reversed and that of the Commissioner of Income tax (Appeals) restored. The substantial questions of law are answered in favour of the Assessee and against the Revenue. No costs.

(H.G.R.,ACJ) (A.S.M.,J)
20.2.2017

Speaking Order/Non-Speaking Order
Index: Yes / no
ssk/vga/sl

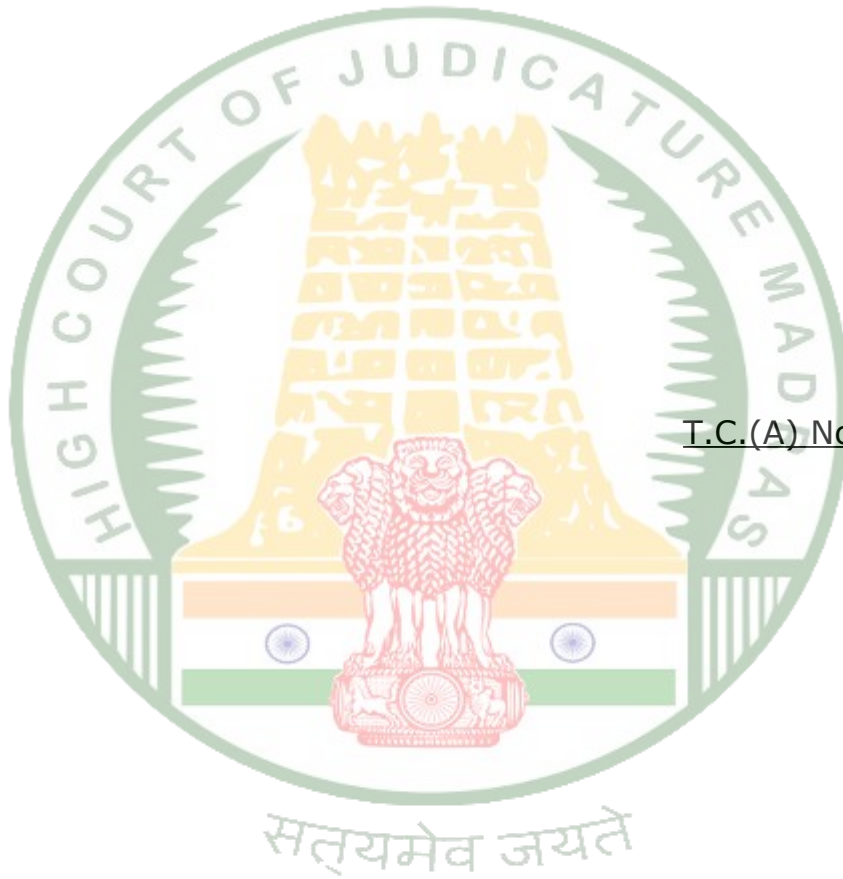
To

The Income Tax Officer (OSD),
Company Circle I(4), Chennai 600 034.

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**HULUVADI G. RAMESH, ACJ.
AND
DR.ANITA SUMANTH, J.**

ssk/vga/sl



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