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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% **Judgment reserved on: 19 March 2024**
Judgment pronounced on: 28 May 2024

\+ ITA 773/2018

THE COMMISSIONER OF INCOME TAX-INTERNATIONAL TAXATION-3 ..... Appellant

Through: Mr. Sanjay Kumar, SSC along with Ms. Hemlata Rawat & Ms. Easha Kadian, JSCs.

versus

THE BANK OF TOKYO-MITSUBISHI UFJ LTD. ..... Respondent

Through: Mr. Percy Pardiwalla, Sr. Adv. with Mr. Hiten Thakkar, Mr. Nikhil Ranjan & Mr. Kamal Arya, Advs.

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Through: Mr. Percy Pardiwalla, Sr. Adv. with Mr. Hiten Thakkar, Mr. Nikhil Ranjan & Mr. Kamal Arya, Advs.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR KAURAV

J U D G M E N T

YASHWANT VARMA, J.

1. The Commissioner of Income Tax impugns the order of the **Income Tax Appellate Tribunal**[1] dated 30 January 2018. As would be evident from our order of 20 December 2023, although as many as five questions stood framed for our consideration in this appeal, the Court had dismissed the prayer for admission of Question Nos. (i) to (iv).

2. While dealing with Question Nos. (i) to (iv) as proposed, the Court took note of the decision rendered on ITA 604/2015 and ITA 605/2015 inter partes on 08 April 2016 and which would have been determinative of the issue which stood raised. Thus, the appeal now stands confined to Question (v) which reads as follows: -

> "(v) Whether the interest received by the Indian PE on deposit maintained with Head Office/Overseas Branch is not taxable in India?"

3. The aforesaid issue arises in the context of interest received by the **Permanent Establishment**[2] of the Bank of Tokyo Mitsubishi UFJ Ltd., now known as MUFG Bank, comprising of branches in India from its overseas branches and Head Office. During the **Assessment Year**[3] in question, namely AY 2003-04, that sum was quantified at INR

[1] Tribunal
[2] PE
[3] AY

7,002,160/-. The aforesaid constituted interest earned by the PE in India on balances maintained either with its Head Office or other overseas branches outside India. The taxability of interest received has been answered in favour of the respondent-assessee with the Tribunal observing as follows: -

> "**20.** Ground No. 5 of the appeal for Assessment Year 2003-04 of the assessee is with respect to the interest of Rs. 7002160/- received by the Indian PE of the appellant on deposit maintained with the head office and its taxability. Undisputedly in the case the appellant had itself included the interest received by Indian PE on deposits maintained with Head office in the total taxable income. However, the same was challenged before the ld CIT(A) stating that such interest income is payment to self as payer and payee both are the same persons. Further it has been submitted that interest paid by HO is not in connection with any indebtedness but on account of deposits. The ld CIT(A) stated that claim is not eligible in view of the decision of the Hon'ble Supreme Court in case of Goetz India Ltd Vs. CIT 284 ITR 323.
>
> **xxxx xxxx xxxx**
>
> **23.** We have carefully considered the rival contentions and also perused the order of the coordinate bench in ITA No. 306/Del/2016 for Assessment Year 2011-12 wherein, the claim of the assessee is discussed and allowed vide para No. 5 to 8 of the order. Therefore, we are of the view that issue is covered in favour of the assessee by the above order of the coordinate bench. Accordingly, we set aside the impugned order and direct the ld AO to delete the above addition. In the result ground No. 5 of the appeal of assessee for both the years are allowed."

4. Although the appellants have referred to the pendency of other appeals before this Court, we note that the orders passed on 08 April 2016 on ITA 604/2015 and ITA 605/2015 would bind parties insofar as the first four questions which were proposed are concerned.

5. Before us, there is no dispute that it would be the provisions of the India-US **Double Taxation Avoidance Agreement**[4] which would govern and, according to the appellants, be liable to be read as supportive of its challenge on the issue of taxability.

6. Mr. Pardiwalla, learned senior counsel appearing for the respondent-assessee, had submitted that Article 7(2) of the India-US DTAA deals with the aspect of attribution of income to a PE. However, insofar as Article 7(3) is concerned, it makes special provisions in respect of a banking enterprise. Article 7(3) of the India-US DTAA is extracted hereinbelow: -

> " **ARTICLE 7**
>
> **BUSINESS PROFITS**
>
> **xxxx xxxx xxxx**
>
> **3.** In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for

[4] DTAA

> amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices "

7. Mr. Pardiwalla drew our attention to the aforesaid Article in clear terms providing that no account would be taken while determining the profits of a PE for amounts charged by it by way of royalties, fees or other similar payments or for that matter commission or other charges for specific services performed or by way of interest on monies lent to the head office of the enterprise or any of its other offices except in the case of a banking enterprise.

8. It was submitted that Article 14(3) of the India-US DTAA, however, and more specifically deals with a reverse situation where interest is paid by the PE of such a company in India to the Head Office and makes the following provisions: -

> "
> **ARTICLE 14**
> **PERMANENT ESTABLISHMENT TAX**
>
> **xxxx xxxx xxxx**
>
> **3.** In the case of a banking company which is a resident of the United States, the interest paid by the permanent establishment of such a company in India to the head office may be subject in India to a tax in addition to the tax imposable under the other provisions of this Convention at a rate which shall not exceed the rate specified in paragraph 2(a) of Article 11 (Interest)."

9. Mr. Pardiwalla also highlighted the similarity between the terms as they stand incorporated in the India-US DTAA insofar as banking enterprises are concerned and the position that emerges from a reading

of covenants contained in other tax treaties. Learned senior counsel firstly drew our attention specifically to identical provisions which stand incorporated in Article 7(3) of the India-Netherlands DTAA and which reads thus: -

> "
>
> **ARTICLE 7**
>
> **BUSINESS PROFITS**
>
> xxxx xxxx xxxx
>
> 2. (a) In determining the profits of a permanent establishment, there shall be allowed as deductions, expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. Provided that where the law of the State in which the permanent establishment is situated imposes a restriction on the amount of the executive and general administrative expenses which may be allowed, and that restriction is relaxed or overridden by any Convention between that State and a third State which enters into force after the date of entry into force of this Convention, the competent authority of that State shall notify the competent authority of the other State of the terms of the corresponding paragraph in the Convention with that third State immediately after the entry into force of that Convention and, if the competent authority of the other State or requests, the provisions of this sub-paragraph shall be amended by protocol to reflect such terms.
>
> (b) However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other

offices, by way of royalties, fees or other similar payments except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise, or any of its other offices."

10. Learned senior counsel also placed for our consideration the India-Japan DTAA and where the following provisions stand incorporated and would be relevant to answer the question which stands posited:-

"

ARTICLE 7

1. The profits of an enterprise of a Contracting State shall be taxable only in that Contracting 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 that other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment.

2. 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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the Contracting State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this article.

> **5.** No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
>
> **6.** For the purposes of the provisions of the preceding paragraphs of this article, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary. 7. Where profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article."

11. Although Article 7(2) of the India-Japan DTAA stands framed on lines similar to other treaties while dealing with the principle of attribution, the Protocol to the aforesaid Treaty makes the following significant provisions insofar as interest on monies paid or charged by a PE and the exception made in respect of a banking institution come to the fore. Clause 8 of the Protocol to the India-Japan DTAA reads as under: -

> "**8.** With reference to paragraph 3 of article 7 of the Convention, no deduction shall be allowed in respect of amounts paid or charged (other than reimbursement of actual expenses) by a permanent establishment of an enterprise to the head office of the enterprise or any other offices thereof, by way of : (a) royalties, fees or other similar payments in return for the use of patents or other rights, or for the use of know-how; (b) commission or other charges, for specific services performed or for management; and (c) interest on moneys lent to the permanent establishment; except where the enterprise is a banking institution."

12. On a more fundamental plane, it was Mr. Pardiwalla's submission that it would be wholly incorrect to view a branch or a subsidiary office of a parent entity as constituting a separate legal personality. It was his submission that branches do not have a separate legal entity and thus the taxability of the interest that was received must necessarily be answered in favour of the assesse. Learned senior counsel in this connection drew our attention to the following pertinent

observations as rendered by the Bombay High Court in **DIT (I.T.) v. Credit Agricole Indosuez**[5]**.**

> " Regarding question 5
>
> (a) Mr. Tejveer Singh, the learned counsel for the Revenue, submitted that this question ought to be admitted as a similar issue has been admitted by this court. In support Mr. Singh tenders the order dated February 14, 2013, of this court in Income Tax Appeal (L.) No. 2078 of 2012, in DIT v. Antwerp Diamond Bank N. V. The question on which the above appeal was admitted reads as under:
>
> > "(a) Whether, on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that interest payable by the Indian permanent establishment of the foreign bank to its head office and other overseas branches, is deductible in computing the total income?"
>
> (b) Mr. Pardiwala, the learned senior counsel for the respondent, contests the submission on behalf of the Revenue and submits that in the present case the question as raised by the Revenue is not in respect of deducting the payment of interest to compute the total income but with regard to the chargeability to tax of the interest received by the Indian permanent establishment from its head office in computing the total income. It is pointed out that the Indian permanent establishment and the head office are one and the same person. It is settled position that one cannot make a profit out of oneself as held by the apex court in Sir Kikabhai Premchand v. CIT (1953) 24 ITR 506 (SC). The impugned order of the Tribunal also places reliance upon the Special Bench decision in the case of Sumitomo Mitsui Banking Corpn. v. Deputy DIT (2012) 16 ITR (Trib) 116 (Mumbai) [SB] ; (2012) 19 taxmann.com 364 (Mum) [SB] to hold that man cannot make profit out of himself and, therefore, the interest received by the assessee from its own head office is not chargeable to tax.
>
> (c) So far as the reliance by the Revenue on order dated April 14, 2013, of this court admitting the appeal in Antwerp Diamond Bank N. V. (supra), is concerned, deduction on account of interest paid by the Indian permanent establishment to its head office was in the specific context of articles 7(2) and 7(3) of the Indo-Belgium DTAA. The case of Antwerp Diamond Bank N. V. (supra) before the Tribunal was a part of the Special Bench decision in Sumitomo

[5] (2015 SCC OnLine Bom 8421)

Mitsui Banking Corporation. (supra) wherein at paragraph 50, it is held as under (page 149 of 16 ITR (Trib):

> "50. As regards the deduction of interest payable to the head office in the hands of Indian permanent establishment for the purpose of computing profits attributable to the said permanent establishment, there is no dispute that such deduction is not permissible under the Indian Income-tax Act (domestic law) being the payment made to self. Both the Indian permanent establishment and the foreign general enterprise of which it is a part are not separate entities for the purpose of taxation under the domestic law and the same being one and the same entity recognised as one assessee under the domestic law, interest payable by Indian permanent establishment to foreign general enterprise of which it is a part, cannot be treated as expenditure allowable as deduction being payment to self. This position which is well settled under the domestic law has not been disputed even by the learned representatives of the assessees during the course of hearing before us. They, however, have relied on the relevant tax treaties in support of the assessee's claim for deduction on account of interest payable to general enterprise while computing the profits attributable to permanent establishment in India as per article 7(2) and 7(3) read with paragraph 8 of the protocol.
>
> 52. A combined reading of article 7(2) and 7(3) of the treaty and paragraph 8 of the protocol thus makes it clear that for the purpose of computing the profits attributable to the permanent establishment in India, the said permanent establishment is to be treated as a distinct and separate entity which is dealing wholly independently with the general enterprise of which it is a part and deduction has to be allowed for all the expenses which are incurred for the purpose of permanent establishment whether in India or elsewhere barring the amount paid by a permanent establishment to the head office of general enterprise or any other offices thereof, inter alia, by way of interest on moneys lent to the permanent establishment except where the enterprise is a banking institution." (emphasis supplied)
>
> It would thus be noticed from the order of this court dated February 14, 2013, admitting the Revenue's appeal, in the case of Antwerp Diamond (supra) arose from a different factual matrix, viz., specific provision of the DTAA allowing deduction and not under the regular provisions of Income- tax Act. Thus, the fact that the appeal in the case of Antwerp Diamond (supra) is admitted would have no relevance for

> admitting the present appeal on the proposed question No. 5. It is also necessary to point out that the Tribunal in the impugned order has recorded the fact that the respondent-assessee has admitted before it that to bring about parity, it is not claiming any deduction of interest paid by it to its head office while computing the taxable income.
>
> (d) Accordingly, in view of the above settled position that no person can make profit out of itself, the proposed question of law not being substantial, is not entertained."

13. As is evident from the aforesaid passages of the judgment in *Credit Agricole*, the Bombay High Court had taken note of the indubitable and well settled position of branch offices not being separate personalities or juridical entities and that one person cannot thus profit from itself. Since the receipt of interest was from the Head Office of the respondent-assessee, it was according to Mr. Pardiwalla, the aforesaid principles which would govern.

14. Our attention was also drawn to the **Central Board of Direct Taxes**[6] Circular No. 19/2015 and which while explaining the provisions of **Finance Act, 2015**[7] had this to state insofar as the Explanation to Section 9(1)(v) of the **Income Tax Act, 1961**[8] is concerned. We deem it apposite to extract the following paragraphs from that Circular: -

> "**9.4** The CBDT, in its Circular No. 740 dated 17/4/1996 had clarified that branch of a foreign company in India is a separate entity for the purpose of taxation under the Income-tax Act and, accordingly, TDS provisions would apply along with separate taxation of interest paid to head office or other branches of the non-resident, which would be chargeable to tax in India.
>
> **9.5** Some of the judicial rulings in this context have held that although under the provisions of the Income-tax Act the payment of

[6] CBDT
[7] 2015 Act
[8] Act

interest by the branch to head office is non-deductible under domestic law, being payment to the self, however, such interest is deductible due to computation mechanism provided under the DTAA but it is not taxable in the hands of the Bank, being income generated from self. The view expressed in the CBDT circular has not found favour in these judicial decisions. If the legal fiction created under the treaty were treated to be of limited effect, it would have led to base erosion. The interest paid by the permanent establishment to the head office or other branch etc. is an interest payment sourced in India and is liable to be taxed under the source rule in India. This position is also recognised in some of our DTAAs, in particular Article 14 (3) the Indo-USA DTAA which reads as under:-

> "*In the case of a banking company which is resident of the United States, the interest paid by the permanent establishment of such a company in India to the head office may be subject in India to tax in addition to the tax imposable under the other provisions of this Convention at a rate which shall not exceed the rate specified in paragraph 2(a) of Article 11 (Interest)*"

9.6 The Special Bench of the ITAT in the case of Sumitomo Mitsui Banking Corporation [136 ITD- 66 TBOM] had mentioned that there are instances of other countries providing for specific provisions in their domestic law which allows for the taxability of interest paid by a permanent establishment to its head office and other branches and had pointed out absence of such a specific provision in the Income-tax Act. Considering that there were several disputes on the issue which were pending and likely to arise in future, it was essential that necessary clarity and certainty is provided for in the Income-tax Act.

9.7 Accordingly, the Income-tax Act has been amended to provide that in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment in India of such non-resident to the head office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the permanent establishment in India. The permanent establishment in India shall be deemed to be a person separate and independent of the non-resident person of which it is a permanent establishment and the provisions of the Income-tax Act relating to computation of total income, determination of tax and collection and recovery would apply. Accordingly, the PE in India shall be obligated to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Further, non-deduction would result in disallowance of interest claimed as

> expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Income-tax Act.
>
> **9.8** ***Applicability:-*** These amendments take effect from 1st April, 2016 and will, accordingly, apply to the assessment year 2016-17 and subsequent assessment years.

15. It becomes pertinent to note that the Explanation to Section 9(1)(v) of the Act is principally concerned with entities engaged in the business of banking and a PE in India once remitting payments to its Head Office, the statute giving rise to a legal fiction of such remittances being deemed to have accrued or arisen in India. The Explanation to Section 9(1)(v) of the Act is reproduced hereinbelow: -

> "[Explanation.— For the purposes of this clause,—
> (a) it is hereby declared that in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment in India of such non-resident to the head office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the permanent establishment in India and the permanent establishment in India shall be deemed to be a person separate and independent of the non-resident person of which it is a permanent establishment and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly;
>
> (b) "permanent establishment" shall have the meaning assigned to it in clause (iii-a) of Section 92-F;]"

16. It is the aforenoted provision which introduces a statutory fiction by ordaining that a PE of a banking enterprise in India would be deemed to be a person separate and independent of the non-resident person of which it is a PE. However, it was the undisputed position before us that the said Explanation would have no application since it

came into effect only from 01 April 2016 and by virtue of Finance Act, 2015.

17. That only leaves us to examine the challenge that stands raised based on the well settled position of the law clearly not contemplating a person profiting out of itself. Once we come to the firm conclusion that the branch office would not partake the character or attribute of a separate legal personality, the view as taken by the Tribunal is clearly rendered unexceptional. In any event, it would be the exception carved out in the DTAA with respect to banking enterprises which would govern.

18. At this juncture, we deem it apposite to extract the following passages from the decision rendered by the Supreme Court in **Kikabhai Premchand KT v. Commissioner of Income Tax (Central), Bombay**[9]:-

> "**10.** It is well recognised that in revenue cases regard must be had to the substance of the transaction rather than to its mere form. In the present case disregarding technicalities, it is impossible to get away from the fact that the business is owned and run by the assessee himself. In such circumstances we are of the opinion that is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a fictional profit which in truth and in fact is non-existent. Cut away the fictions and you reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the face of it is not only absurd but against all canons of mercantile and income tax law. And worse. He may keep it and not show a profit. He may sell it to another at a loss and cannot be taxed because he cannot be compelled to sell at a profit. But in this purely fictional sale to himself he is compelled to sell at a fictional profit when the market

[9] (1953 SCC OnLine SC 127)

rises in order that he may be compelled to pay to Government a tax which is anything but fictional."

19. Accordingly, and for the aforesaid reasons, we find no merit in these appeals. They shall consequently stand dismissed.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

MAY 28, 2024/RW