IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'B' NEW DELHI

BEFORE SHRI G.D. AGRAWAL, HON'BLE PRESIDENT
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

ITA No. 4986/Del/2007
Assessment Year: 2003-04

Clough Engineering Ltd., **Level-2, 22 Mount St. Perth,** **West Australia,** **Australia.**	**vs**	**Asstt. Commissioner of Income Tax (OSD), Range 1, Dehradun.**

ITA No. 4771/Del/2007
Assessment Year: 2003-04

Asstt. Commissioner of Income Tax (OSD), Range 1, Dehradun. **(Appellant)**	**vs**	**Clough Engineering Ltd., Australia.** **(Respondent)**

Appellant by: Shri Daksh S. Bhardwaj, Adv.
Respondent by: Shri Anuj Arora, CIT DR

ORDER

PER SUDHANSHU SRIVASTAVA, JM

These are cross appeals pertaining to AY 2003-04.

2. The assessee is a non-resident company incorporated in Australia. The return was filed at an income of Rs. 1,49,15,800/- claiming the income taxable as per the Double Taxation Avoidance Agreement (DTAA) with Australia. The assessee has been executing turnkey contracts in India, mainly offshore, for installation of infrastructure for carrying out oil exploration activities for companies such as ONGC, Cairn Energy etc. During

the relevant previous year, the assessee executed another contract with Niko Resources and the scope of work consisted of engineering, procurement, installation, pre-commissioning and commissioning assistance of the offshore and onshore work at Hazira. The assessee received Rs. 73,36,73,348/- for the work executed outside India but pertaining to this contract. The AO treated 2% of such receipts as income and assessment was completed at an income of Rs.15,26,89,530/- without allowing the carry forward of the losses. The Assessing Officer held that the assessee had a Permanent Establishment (PE) in India with respect to its Hazira Offshore Development Project for Niko Resources Ltd. He therefore took at 2% of the receipt as income and did not allow beneficial treatment to the assessee in terms of the provisions of section 90(2) of the Income Tax Act, 1961 which provide that the provisions of the Income Tax Act that are more beneficial to the assessee have to be applied where DTAA exists with the native country of a non-resident assessee. It was the assessee's contention before the Assessing Officer that since the assessee was engaged in the business in connection with exploration and production of mineral oils, the provisions of section 44BB were applicable and, therefore, the income should

have been worked out u/s 44BB of the Act. It was the assessee's contention that no work had been done in India in respect of the contract for Niko Resources Ltd. and all the work in respect of which invoices had been raised and amounts have been received, has been carried out totally outside India. However, the Assessing Officer did not agree with the contentions of the assessee and held that the assessee was assessable under Article VII of DTAA between India and Australia and accordingly, the amount of Rs. 1,46,73,467/- was added to the income of the assessee.

2.1 Further, the assessee had offered interest income on income tax refund and bank interest for being taxed @15% as per the return of income. It was the contention of the assessee that Para 2 of Article XI of DTAA between India and Australia provided that the tax shall not exceed 15% of gross amount of interest. However, the Assessing Officer held that the assessee had derived interest income on refund of TDS made out of business receipts as also the interest from bank was on business funds. The Assessing Officer held that the interest income was, therefore, directly connected with the business receipts and was therefore assessable under Article VII of Indo Australia DTAA as business income to be subjected to normal rate of tax.

2.2 Aggrieved, the assessee carried the matter to the Ld. CIT (A) who rejected the assessee's ground that the interest income should not be treated as business income directly connected with Permanent Establishment (PE). The Ld. CIT(A), however, deleted an addition of Rs. 1,46,73,467/- by holding that PE has to be reckoned project wise and since the activities with reference to the Niko contact were carried out completely outside India, there was no tax liability with regard to these overseas services. Now, both the department as well as the assessee have approached the ITAT and have raised the following grounds:-

ITA 4986/Del/2007 – Filed by the assessee:

> *"1. That on the facts and the circumstances of the case and in law, the Commissioner of Income Tax (Appeal) [hereinafter referred to as 'CIT (A)'] has erred in treating the interest income as business income directly connected with Permanent Establishment and taxing the same. CIT (A) has thereby erred in ignoring the provisions of Tax Treaty between India and Australia.*
>
> *2. That on the facts and the circumstances of the case and in law, the CIT (A) has erred in rejecting ground of your appellant interest granted by department and withdrawn in subsequent year, should not be taxed in granting of interest.*
>
> *3. That on the facts and the circumstances of the case and in law, the CIT (A) has erred in upholding the levy of interest under section 234D of the Act."*

ITA No. 4771/Del/2007 – filed by the revenue:

"1. The learned CIT (Appeals) has erred in law and on facts in deleting the addition of Rs. l,46,73,467/- in respect of Hazira Project by holding that the work in respect of this project was performed outside India without appreciating the fact that the assessee had a PE in India and the contract is for composite work and only part portion of contract was carried outside India by sub contracting that part to sub contractor.

2. That the ld.CIT (Appeals) has erred in law and on facts in relying upon the decision of Hon'ble Supreme Court in the case of Hyundai Heavy Industries the work was carried out before the PE was created with is not the case in the case of the assessee company.

3. That the ld.CIT(Appeals) has erred in law and on facts in allowing set of loss for A.Y. 2001-02 on the basis that the order u/s 263 passed by CIT has been cancelled by the 1TAT, a decision which has not been accepted by the department.

4. That the Ld. CIT (Appeals) has erred in law and on facts in cancelling the interest charged u/s 234B."

2.3 A Special Bench was constituted on 7.10.2010 to decide ground no. 1 of the assessee's appeal. The question was as under:-

"Whether, on the facts and in the circumstances of the case, interest on income tax refund and fixed deposits with the bank is liable to tax with reference to Article 7 read with paragraph no. 4 of Article 11 or Para no. 2 of Article 11 of Indo-Australia Double Taxation Avoidance Agreement?"

2.4 The Special Bench decided the question as under:-

"11.4. Thus, we are again left with the fundamental question as to whether the debt claim in this case can be said to be effectively connected with the PE. We have already held that the claim is connected with the PE in the sense that it has arisen on account of tax deduction at source from the receipts of the PE. However, it is also a fact that payment of tax is the responsibility of the foreign company. The same is determined after computation of its income and the tax forum not an expenditure for earning the income but an item of appropriation of profit. Therefore, even if the debt is connected with the receipts of the PE, it cannot be said to be effectively connected with such receipts because the responsibility to pay the tax lies on the shoulders of the assessee company from the final profit ascertained as on the last date of the previous year and on closing the books of account. It is for the company to pay the tax from any source available with it. It so happened in this case that the tax got automatically deducted from the receipts of the PE by operation of law. Such collection of tax by force of law would not establish effective connection of the indebtedness with the PE as ultimately it is only the appropriation of profit of the assessee company. However, we may add that we do not venture to say that the interest income has to be necessarily business income in the nature for establishing the effective connection with the PE because that would render provision contained in paragraph 4 of Article XI redundant. Thus, there may be cases where interest may be taxable under the Act under the residuary head and yet be effectively connected with the PE. The bank interest in this case is an example of effective connection between the PE and the income as the indebtedness is closely connected with the funds of the PE. However, the same cannot be said in respect of interest on income-tax refund. Such interest is not effectively connected with PE either on the basis of asset test or activity test. Accordingly, it is held that this part of interest is taxable under paragraph *no. 2 of Article XL Thus, the ground referred to the Special Bench is partly allowed. The Division Bench shall dispose off the appeal in conformity with this order."*

2.5 Subsequent to the order of the Special Bench, a division Bench of the ITAT Delhi disposed of both the appeals vide order dated 29/02/2012 partly allowing both the appeals for statistical purposes.

2.6 However, the assessee moved Miscellaneous Applications against the order dated 29/02/2012 passed by the ITAT which were allowed and the order was recalled vide order dated 31/12/2013 in MA Nos. 88 and 89/Del/2012.

2.7 Now these appeals have come up for hearing before this Bench.

2.8 At the outset, Ld. DR submitted that it has been the Department's contention during earlier hearings that the revenue has already filed an appeal before the Hon'ble High Court of Uttarakhand against the order of the Special Bench and the same stood admitted and, therefore, the said appeal should be referred to a larger Bench. The Ld. AR opposed the department's plea. We have heard the rival submissions and carefully perused the relevant material placed on record. It is our considered opinion that a larger Bench could be constituted in some other

case but it may not be open to constitute a larger Bench in the same case and the same appeal as it is not open to the Tribunal to review its own judgement. Therefore, looking into the facts and circumstances of the case, we deem it fit that the assessee be permitted to press its ground of appeal pertaining to interest on income tax refunds before us.

3. On ground no. 1 of the assessee's appeal, the Ld. AR relied on the decision of the Special Bench in the assessee's own case as referred to above. Ground no.2 was not pressed by the assessee and the same is dismissed as not pressed.

3.1 In response, the Ld. CIT DR placed reliance on the judgment of the Uttarakhand High Court in the case of Pride Foramer SAS reported in (2013) 40 Taxmann.com 100 (Uttarakhand High Court).

3.2 On the department's ground challenging the deletion of addition of Rs.1,46,73,467/- in respect of the Hazira Project, Ld. CIT DR submitted that Ld. CIT(A) has held that the activity fell under clause 2 whereas the Assessing Officer has held it to be under clause (iii)(b) which was after correct appreciation of facts

on record. Ld. CIT DR submitted that it was a deemed PE in terms of Article 5(3)(b) of the DTAA. It was submitted that it is only the assessee's claim that no activity regarding the project was carried out in India but the same is not substantiated from the records.

3.3 Ld. CIT D.R. also filed written submissions to bring out the import of the phrase 'in connection with'. The same is being reproduced for a ready reference:-

"PHRASE 'IN CONNECTION WITH' –

1. *During the relevant period the Article 5 (3) of India-Australia DTAA read as under:*

"3. An enterprise shall be deemed to have a permanent establishment in one of the Contracting States and to carry on business through that permanent establishment if:

(a) …….
(b) it carries on activities in that State in connection with the exploration for or exploitation of natural resources in that State; or"

The phrase 'in connection with' has an expansive meaning and is same as 'having to do with' or 'in relation to'. In other words, a slightly remote connection may suffice for being covered under relevant provisions.

2. *This needs to be contrasted with the phrase 'used, or to be used' which emphasizes that there has to be a direct or close nexus.*

3. The scope and ambit of the words 'in connection with' has been explained by the AAR in its decision in Geofizyka Torun Sp.zo.o, In re, [2010] 186 TAXMAN 213 (AAR), relevant portion of which is reproduced below:

> *"6.1 The expression 'in connection with' is important and has to be construed to have expansive meaning. While explaining the meaning of similar and interchangeable expressions viz. "pertaining to" and "in relation to", the Supreme Court observed in the case of Doypack Systems (P.) Ltd. v. Union of India 1988 (36) ELT201*
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> *"48. The expression 'in relation to' (so also 'pertaining to'), is a very broad expression which presupposes another subject-matter. These are words of comprehensiveness which might both have a direct significance as well as an indirect significance depending on the context, see State Wakf Board **v.** Abdul Aziz AIR 1968 Mad. 79, 81 paragraphs 8 and 10, following and approving Nitai Charan Bagchi **v.** Suresh Chandra Paul 66 C.W.N. 767, Shyam Lai **v.** M. Shayamlal AIR 1933 All. 649 and 76 Corpus Juris Secundum 621. Assuming that the investments in shares and in lands do not form part of the undertakings but are different subject-matters, even then these would be brought within the purview of the vesting by reason of the above expressions. In this connection reference may be made to 76 Corpus Juris Secundum at pages 620 and 621 where it is stated that the term 'relate ' is also defined as meaning to bring into association or connection with. It has been clearly mentioned that 'relating to' has, been held to be equivalent to or synonymous with as to 'concerning with' and 'pertaining to'. The expression 'pertaining to' is an expression of expansion and not of contraction." (p. 219)*
>
> *6.2 In the decision of British Columbia Appellate Court, Vancouer in Nanaimo Community Hotel Ltd. **v.** Canada [1944] 4 DLR 638 which arose under the Excise Profits*

Tax Act, 1940, the following passage is instructive of the real import of the phrase "in connection with":

"Mr. Cunlifee argues that that section presupposes that an assessment has been made, and that as I understand him, the words "in connection with" mean "consequent upon." I do not think that is the correct construction to be put upon these words. One of the very generally accepted meanings of "connection " is "relation between things one of which is bound up with or involved in another"; or again "having to do with". The words include matters occurring prior to as well as subsequent to or consequent upon so long as they are related to the principal thing. The phrase "having to do with" perhaps gives as good a suggestion of the meaning as could be had. I think section 66 is sufficient to oust the jurisdiction of this Court to deal with a decision on which an assessment is subsequently made. "

4.In that case, the court was with interpreting section 66 of the Income War Tax Act which reads as under:

"66. Subject to the provisions of this Act, the Exchequer Court shall have exclusive jurisdiction to hear and determine all questions that may arise in connection with any assessment made under this Act."

3.4 Ld. CIT DR submitted that in view of these judicial precedents on the scope of the words 'in connection with', the assessee's claim regarding the applicability of provisions of Indo-Australia DTAA was not acceptable. Ld. CIT DR also submitted that the department's ground regarding set off of losses may be restored to the file of the Assessing Officer for due verification and examination.

3.5 In response, the Ld. AR placed reliance on the order of the Ld. CIT(A) and submitted that the Ld. CIT(A) has given a concrete finding that from the invoices, it was clear that the engineering services were sub-contracted to a Singapore based company and that the services were provided in Singapore only. Ld. AR submitted that the Ld. CIT (A) has given the finding that as per the contract, the work in respect of the Hazira project was performed outside India, the Assessing Officer was not right in treating 2% of the receipts as income.

3.6 Ld. AR further submitted that the assessee was in the business of setting up infrastructure for exploration of oil which consisted of only laying through the pipelines and therefore, the assessee's case would not fall within the ambit of the phrase 'in connection with'. Ld. AR also submitted that Explanation (1) to section 9 provided that profit attributable only to activities in India has to be taxed in India and since there was no activity in India with regard to the said project in the year under consideration, no income/profit can be attributable to the said project for the said year. Ld. AR also referred to Article VII of the

DTAA to emphasise his contention.

3.7 On the issue of set off of losses, the Ld. AR submitted that the assessee had no objection in the issue being set aside to the file of the Assessing Officer for verification and adjudication.

4.0 We have heard the rival submissions and have produced the material on record. As far as ground No. 1 of the assessee's appeal is concerned, it is seen that the Special Bench has disposed of the issue in paragraph 11.4 of its order by observing, *" .....However, we may add that we do not venture to say that the interest income has to be necessarily business income in the nature for establishing the effective connection with the PE because that would render provision contained in paragraph 4 of Article XI redundant. Thus, there may be cases where interest may be taxable under the Act under the residuary head and yet be effectively connected with the PE. The bank interest in this case is an example of effective connection between the PE and the income as the indebtedness is closely connected with the funds of the PE. However, the same cannot be said in respect of interest on income tax refund. Such interest is not effectively connected with PE either on the basis of asset test or activity test. Accordingly, it*

is held that this part of interest is taxable under paragraph No. 2 of Article XI."

4.01 Accordingly, in view of the decision of the Special Bench, as aforesaid reproduced, we allow ground No. 1 of the assessee's appeal. Ground No. 2 of the assessee's appeal has not been pressed by the assessee and the same is dismissed as not pressed. As far as ground No. 3 of the assessee's appeal is concerned, it challenges the levy of interest under section 234D of the Act. As this ground is consequential, no adjudication is called for.

4.02 In the result the assessee's appeal stands partly allowed.

4.1 As far as the Department's appeal is concerned, ground numbers 1 and 2 challenge the deletion of addition of Rs. 14,673,467/- in respect of the Hazira project. A perusal of the impugned order shows that the Ld. CIT appeals has given the relevant finding in paragraph 3.2 of the impugned order which reads as under:

> *"I have gone through the order of the AO and the submissions of the AR very carefully. The appellant is a contractor with reference to the contract entered with*

M/s Niko Resources. The technical requirements in the form of design, engineering specification etc have been provided by M/s Niko Resources to the appellant who has to execute the contract as per the specifications. It is an admitted fact that all the activities with reference to Niko contract were carried out by the appellant completely outside India. Even the inside India activities did not commence before 2004 and the appellant had not established any office/place of business in India in relation to Niko contract in FY 2002 – 03. It is a settled position that PE has to be reckoned project wise. During the previous year ending on 31.03.2003, appellant has undertaken only a part of the activity relating to designing and this work was carried out entirely outside India. The Supreme Court judgement in the case of Ishikama Heavy Industries Ltd 271 ITR 193 has held that in order to attract the taxing provisions of I.T. Act, there has to be some activities conducted to permanent establishment (PE). There would be no tax liability with regard to overseas services even under the DTAA.

From the invoices, it is clear that engineering services were sub contracted to a Singapore-based company and services were performed in Singapore only. As the work in respect of Hazira project was performed outside India, the AO was not right in treating 2% of the receipts as income. Reliance is also placed on the decision of Supreme Court in the case of CIT versus Hyundai Industries Co Ltd 291 ITR 482 (SC). The AO is directed to delete the addition of Rs. 14,673,467/-."

4.1.1 This finding of fact by the Ld. CIT appeals could not be negated by the Department. Therefore, we find no reason to interfere with the findings of the Ld. CIT appeals and we uphold his adjudication on this issue. Accordingly, ground numbers 1 and 2 of the Department's appeal are dismissed.

4.2 As far as ground No. 3 of the Department's appeal is concerned, both the parties have given their consent that this ground may be restored to the file of the AO. Accordingly, this issue is restored to the file of the AO for examining the issue afresh in light of the available records and after giving due opportunity to the assessee. This ground stands allowed for statistical purposes.

4.3 As far as ground No. 4 challenging the cancellation of interest u/s 234B of the Act is concerned, it is seen that the Ld. CIT (A) has observed correctly that since the entire income of the assessee was subject to deduction of tax at source, the assessee had no liability to pay advance tax. The Ld. CIT (A) has placed reliance of the judgment of the Hon'ble Uttarakhand High Court in the case of CIT vs. Sedco Forex International Drilling Co. reported in 264 ITR 320 and also on another judgment of the Uttarakhand High Court in the case of CIT vs. Haliburton Offshore Services reported in 271 ITR 395 while directing the AO to delete the interest. We do not find any reason to interfere on this issue as the Department could not counter the stand of the Ld. CIT (A) with any judgment to the contrary or bring on record any fact which could prove that the finding of the Ld. CIT (A) was

erroneous. Therefore, this ground also stands dismissed.

4.4 In the result, the Department's appeal stands partly allowed for statistical purposes.

5. In the final result, the assessee's appeal stands partly allowed whereas the Department's appeal stands partly allowed for statistical purposes.

Order pronounced in the open court on 13.4.2017.

Sd/- Sd/-

(G.D. AGRAWAL) (SUDHANSHU SRIVASTAVA)
PRESIDENT JUDICIAL MEMBER

DT. 13th APRIL 2017
'GS'

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

By Order

Asstt. Registrar