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2024:DHC:4330-DB

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* IN THE HIGH COURT OF DELHI AT NEW DELHI

% **Judgment reserved on: 22 February 2024**
Judgment pronounced on: 28 May 2024

\+ ITA 727/2018

JOHNSON MATTHEY PUBLIC LIMITED COMPANY ..... Petitioner

Through: Mr. Percy J. Pardiwalla, Sr. Adv. with Mr. Prakash Kumar, Adv.

versus

COMMISSIONER OF INCOME TAX, INTERNATIONAL TAXATION -2, NEW DELHI ..... Respondent

Through: Mr. Abhishek Maratha, SSC with Mr. Parth Semwal, JSC & Ms. Nupur Sharma, Adv.

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 appellant/ assessee impugns the order of the **Income Tax Appellate Tribunal**[1] dated 06 December 2017. The appeal was originally admitted in terms of an order dated 06 March 2019 and the following question of law came to be accepted for consideration:

> "Whether, on the facts and in the circumstances of the case & in law, the Income Tax Appellate Tribunal erred in dismissing the additional ground raised by the assessee contending that since the source of guarantee for its Associated Enterprises to foreign banks is outside India, the parental corporate guarantee charges of Rs.1,49,15,090/- received from the Indian Subsidiaries cannot be held taxable in India?"

[1] Tribunal

2. Subsequently and more particularly on 24 November 2023 the following additional question of law came to be framed by the Court for consideration:

> "Whether the Income Tax Appellate Tribunal/DRP/AO erred on fact and in law in concluding that guarantee commission, amounting to Rs. 1,49,15,090/- received by the appellant/assessee, did not come within the ambit of the expression interest as found in Article 12(5) of the Indo-UK DTAA?"

3. The issue itself arises out of the receipt of guarantee charges by the appellant from its Indian subsidiaries in terms of an **Intra Group Parental Guarantee and Counter Indemnity Services Agreement**[2] dated 29 March 2010. It had been the case of the appellant that it had initially and out of abundant caution characterized the amount of guarantee charges as being interest and taxable in terms of Article 12 of the **Agreement for Avoidance of Double Taxation & Prevention of Fiscal Evasion with United Kingdom of Great Britain and Northern Ireland**[3]. During the course of assessment undertaken in accordance with the procedure prescribed under Section 144C of the **Income Tax Act, 1961**[4]**,** the **Assessing Officer**[5] as well as the **Dispute Resolution Panel**[6] took the position that the sum would be liable to be taxed under Article 23(3) of the DTAA and thus liable to be characterized as falling under the head of 'other income'.

4. When the matter reached the Tribunal, the assessee assailed the correctness of the view as taken by the AO as well as the DRP and reiterated its stand with respect to interest income being liable to be taxed under Article 12 of the DTAA without prejudice to its other

[2] Intra Group Agreement
[3] DTAA
[4] Act
[5] AO
[6] DRP

submissions that the income was not taxable at all. In that appeal it raised an additional ground with respect to the taxability of guarantee charges asserting that since its source was outside India, it was not taxable under the Act. As would be apparent from the recordal of submissions by the Tribunal, the appellant alternatively also appears to have argued that the receipt of guarantee charges could also fall within the ambit of 'business income' and which would then be governed by Article 7 of the DTAA. It appears to have been urged that in the absence of the assessee having a **Permanent Establishment**[7], the business income would not be chargeable under the DTAA.

5. It becomes pertinent to note that even before us the issue of guarantee charges answering to the description of business income was elaborately addressed by learned counsels appearing for respective sides. Mr. Pardiwalla, learned senior counsel, had while seeking to explain the ambit and scope of business income had placed for our consideration the decisions rendered by the Supreme Court in **S.A. Builders Ltd. vs Commissioner of Income-tax (Appeals), Chandigarh**[8], **G. Venkataswami Naidu & Co. vs Commissioner of Income Tax**[9], **Dalmia Cement Ltd. vs Commissioner of Income Tax, New Delhi**[10], as well as a judgment rendered by the Bombay High Court in **Vassanji Sons & Co. (P.) Ltd. vs Commissioner of Income –Tax**[11] to contend that the guarantee charges received would be liable to be treated as business income.

6. It was in the same context that Mr. Maratha, learned counsel

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[7] PE
[8] (2007) 158 taxman 74 (SC)
[9] (1959) 35 ITR 594
[10] (1976) 4 SCC 614
[11] (1980) 125 ITR 462 (Bombay

appearing for the respondent, had relied upon the judgment rendered by the Bench of the Tribunal at Ahmedabad in **Micro Link Limited vs Addl. Commissioner of Income Tax**[12] as well as a decision rendered by the Calcutta Bench of the Tribunal in **Metso Outotec OYJ vs DCIT**[13]**.**

7. While it was on the aforesaid basis that we had upon conclusion of oral submissions reserved this matter for judgment, it becomes apparent from a reading of the two solitary questions on which the appeal stands admitted are confined to the characterization of guarantee charges under Article 12 of the DTAA and whether income derived from the receipt of guarantee fee could be said to arise or accrue in India.

8. We are also constrained to observe that the appellant did not address any request for the framing of an additional question pertaining to business income and the ambit of Article 7 of the DTAA. We thus and, consequently, find ourselves unable to deal with the various contentions which were addressed on that score.

9. Insofar as the question pertaining to guarantee charges being liable to be viewed as interest under Article 12 of the DTAA is concerned, we note that the Tribunal has while examining this aspect observed as follows:

> "**17.** A bare reading of these provisions indicate that either the debt claims of any kind or the service fee or other charge in respect of moneys borrowed or debt incurred, refer to the payments relating to the debt proper, whether or not there is any relationship of debtor-creditor or borrower-lender. At this juncture, we would like to observe that words and phrases· employed in any provision of Statute or Treaty have to be understood in the context of their usage

[12] I.T.A. No. 2873/Ahd/10
[13] ITA No. 300/KOL/2022

and with reference to the company of other words or phrases they keep in. Too much of expansion of the literal meaning, in disregard to the context or privity of contract would lead to absurdity or negation of the purpose of the provisions. The word "interest" as found in Article 12(5) of the Treaty and section 2(28A) of the Act, shall have be understood contextually and with reference to the other words· and phrases in whose company it is to be found. Though the words "claims of any kind", or "service fee or other charge" are to be found either in the Treaty or in the Act, with reference to interest, every periodical payment or remuneration for service in the context of a loan cannot be treated as “interest”. The term interest, with its widest connotations, indicate the payments, whatever may be the name that is called with, relate to the payments made by the receiver of some amount, pursuant to a loan transaction. Loan transaction is also a species of contract. Art 12(5) of the DTAA and Section 2(28A) of the Act extend the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as "interest", necessarily have to be within the context of loan and shall relate to the parties to the privity of contract. In this context only, the expressions "claims of any kind", "service fee or other charge" have to be understood. So also the expression "whether or not there is the relationship of creditor-debtor or lender-borrower exists". It is only in the context and privity of contract, the payments covered by Article 12(5) of the India U.K. treaty or 2(28A) of the Act would be qualified to be treated as interest, even if there is no semblance of relationship between the parties like that of creditor-debtor exists. However, it does not take into its fold any payments made to stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan. Undoubtedly, assessee is a stranger to the privity of loan transactions inasmuch as the contract of loan is a different from the contract of guarantee, as such in our considered opinion, the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" does not stand extended to the payment of guarantee commission received by the assessee in India. The payments relating to debt claims, service fee or other charge, could be categorized as interest provided they is privity of such contract. Lest we are afraid that the thin line that separates the payment of interest from other payments will be missing and the payments towards consultancy charges, expenditure incurred for the purpose of pre-loan documentation and the host of expenditure incurred with third parties and not relatable to the loan transaction proper, will have to be treated as “interest”. Certainly it cannot be the intention of the legislature or treaty makers. We are, therefore, of the considered opinion, that, so long as the assessee is a stranger to the privity of contract of loan between the Indian entity and the

banker, they cannot categorize the corporate/ bank guarantee recharge amount as interest for the purpose of taxation."

10. Dealing with the issue of whether guarantee charges could be said to be income which had arisen or accrued in India, the Tribunal has made the following pertinent observations:

> "**9.** At the outset, it is needless to say that while according to Section 4 of the Act income-tax shall be charged in accordance with, and subject to the provisions (including provisions for the levy of additional income tax) of the Act in respect of the total income of the previous year of every person, Section 5(2) of the Act says that, the total income of any previous year of a person who is a non-resident shall include all income from whatever source derived which is received or is deemed to be received in India in such year by or on behalf of such person; or accrues or arises or is deemed to accrue or arise to him in India during such year. It is, therefore, clear that in cases covered under section 5(2) of the Act, there are no escapes for the receipts from being included in the total income of the Non-resident Indian. In the case on hand, though it is contended by the assessee that they have entered into the global corporate" guarantee agreement with the banker outside India, fact remains that on that account alone, no receipts would accrue to the assessee in the jurisdictions where the loan facility is not availed by the subsidiaries. It is not the entering of the global corporate agreement outside India that occasions the assessee to charge the guarantee commission, but it is the act of the subsidiary in availing the loan that accrues the guarantee commission to the assessee. So long as there is no denial that the loan transaction took place in India, it is not open for the assessee to contend that no income accrued to them in India. We are fortified in our this opinion, by the decision of the Hon'ble Apex Court in Kanchanganga Sea Foods Pvt. Lgd. Vs. CIT (2010) 325 ITR 540 (SC) where the Hon'ble Court held that in cases of the receipts created by legal fiction under section 5(2) of the Act, there is no escape from the conclusion that the income earned by the non-resident company had received the same in India.
>
> **10.** In these circumstances, in view of the legal fiction followed by the Hon'ble Supreme Court in the above decision while considering section 5(2) of the Act, we are of the considered opinion that the parental/bank guarantee commission was accrued to and received by the assessee in India as such the assessee cannot succeed in their plea that such a receipt is not taxable in India."

11. Proceeding further to deal with the aspect of business income,

the Tribunal took the view that since the appellant was not engaged in the business of providing corporate or bank guarantees, guarantee charges cannot be held to be business income and would thus not fall within Article 7 of the DTAA. It additionally and in this regard bore in consideration the fact that the global corporate guarantee was for the limited purposes of securing loans to its subsidiaries. This aspect was answered in paragraph 18 as follows:

> "**18**. Alternative request of the assessee is that, if for any reason the Tribunal reaches a conclusion that this Corporate/Bank guarantee recharge cannot be treated as interest, then the question as to whether *it* amounts to business income may be considered. On this aspect, we find from the record that admittedly the assessee is manufacturing technologically advanced chemicals known as catalysts used in automobile and other industries, it manufactures a variety of precious metal containing catalysts and chemical products which are used in a wide range of industrial applications. Further, it is nobody's case that the assessee also does the business of providing corporate/bank guarantee recharge to earn income on regular basis. The global corporate guarantee that was entered into by the assessee is only for the limited purpose of securing loans to its subsidiaries and the recharge income is only an incidental one. In these circumstances, we find it difficult to accede the argument that the corporate/bank guarantee recharge would be business profit, for application of Article 7 of the India UK DTAA."

12. Appearing for the appellant Mr. Pardiwalla, learned senior counsel submitted that the Tribunal has clearly erred in holding that the income accrued or arose in India ignoring the fact that the fee was earned as consideration for bearing the risk of default on the part of the Indian subsidiary which was the principal debtor. It was contended that since the risk would ultimately be borne by the appellant outside India and where it could face the specter of coercive proceedings being initiated against its overseas financial assets, the income received would clearly fall outside the scope of Section 5(2) of the Act. According to learned senior counsel, notwithstanding the appellant

having a business connection in India, the amount of guarantee charges as received would also not be chargeable to tax in terms of Explanation 1(a) of Section 9(1)(i) of the Act. Mr. Pardiwalla, in this behalf placed reliance on the decision rendered in **Capgemini S.A. vs. ADIT(International Taxation)**[14] by the Mumbai Bench of the Tribunal where while dealing with a similar question it had opined as under:

> "**5.** We have considered rival contentions and found that the AO taxed the guarantee commission on the plea that guarantee has been provided for the purpose of raising finance by an India company. As per the AO finance was raised in India. The AO further observed that finance requirement is met by a Indian branch of the bank, the benefits of guarantee are shared by the Indian entity with the assessee by making a compensatory payment. Accordingly the AO held that fees for guarantee arise in India. From the record we found that guarantee commission received by France company did not accrue in India nor it can be deemed to be accrued in India, therefore, not taxable in India under Income Tax Act. Furthermore, as per Article 23.3, income can be taxed in India, only if it arises in India. In the instant case, the income clearly arises in France because the guarantee has been given by the assessee, a French company to BNP Paribas, a French Bank, in France and, therefore, Article 23.3 has no applicability as income does not arise in India."

Our attention was also drawn to a subsequent decision rendered by the Tribunal in yet another matter of **Capgemini S.A. vs DCIT (International Taxation)-2(1)(1), Mumbai**[15] and where the earlier decision came to be reiterated.

13. For the purposes of explaining the source of income and the nature of services which are concerned with the extension of guarantees, Mr. Pardiwalla also sought to draw sustenance from a decision handed down by the United States Court of Appeals for the Fifth Circuit in **Container Corporation vs Commissioner of Internal**

[14] ITA No. 7198/Mum/2012

[15] ITA No. 888/Mum/2016

Revenue[16]. Mr. Pardiwalla invited our attention to the following passages from that decision:

> " To determine what class of income guaranty fees fall within or may be analogized to, the court must look to the "substance of the transaction." Bank of America v. United States, 680 F.2d 142, 147 (Ct. Cl. 1982). The Commissioner contends the guaranty fees are more closely analogized to interest, while Container Corporation argues that the fees are more closely analogous to payment for services. See Howkins v. Comm'r, 49 T.C. 689 (1968) (applying by analogy the sourcing rule for the income type that is most similar to the income in question where that income is not covered under a specific statutory sourcing rule).
>
> Looking to the substance of the transaction, the Tax Court found that the guaranty fees were more closely analogous to payments for services. Container Corp. v. Comm 'r, 134 T.C. 122 (2010). International, the domestic corporation, paid Vitro, its Mexican parent corporation, fees to guarantee notes issued by International. Id. at 129. The guaranty here was not a loan transaction as no money was exchanged. Vitro's obligations under the guaranty were contingent on International's default. Thus, the guaranty was issued as a secondary obligation. The factual basis of the guaranty and guaranty fee payments relied on by the Tax Court evidence that Vitro was being compensated for its promise to stand by in the event a future obligation materialized and not for putting its money at risk at the time of signing the guaranty. Accordingly, the Tax Court's factual findings are not clearly erroneous, nor is its ultimate characterization incorrect.
>
> It is clear that the source of payments for services is where the services are performed not where the benefit is inured. See Comm'r v. Piedras Negras Broadcasting Co., 127 F.2d 260, 261 (5th Cir. 1942). The Tax Court held that Vitro's promise to pay in the event of default produced the guaranty fees. Vitro's guaranty was the service. Thus, the services were performed in Mexico, and International did not have to withhold thirty percent of the guaranty fees paid. Container Corp., 134 T.C. at 140.
>
> Under these factual circumstances, the guaranty fees are more analogous to payments for services, and the income was properly sourced outside the United States. As we find no reversible error of fact or law, the judgment of the Tax Court is AFFIRMED."

[16] No. 10-60515 [Appeal from the decision of the United States Tax Court USTC No. 3607-05]

14. It may be noted that the decision in *Container Corporation* was principally concerned with the issue of identifying the jurisdiction within which income could be said to have arisen or accrued. The Court of Appeals ultimately found that since the secondary obligation was to be performed outside the United States, the view taken by the Tax Court was correct.

15. Appearing for the respondents, Mr. Maratha, learned counsel, submitted that the Tribunal has correctly come to conclude that income had accrued in India since, and in terms of Section 5(2) of the Act, the same was received as a consequence and a corollary to the loans availed by the Indian subsidiaries. Learned counsel submitted that since the loan transaction had undoubtedly taken place in India, it would clearly not be open for the appellant to contend that no income had accrued to them in India. For the purposes of elucidating the meaning to be ascribed to the word 'accrue' and 'arise' as appearing in Section 5 of the Act, Mr. Maratha commended for our consideration the judgment of the Supreme Court in **E.D. Sassoon & Company Ltd. vs. The Commissioner of Income-Tax, Bombay**[17] and which over the decades has acquired a classical place in the jurisprudence explaining the meaning of the expressions "arise" and "accrue". Mr. Maratha in light of the above submitted that since accrual of income is not concerned with actual receipt, it would be incorrect for the appellants to assert that income had not arisen or accrued in India.

16. Insofar as the Article 7 question is concerned, Mr. Maratha pointed out that the issue of whether a PE of the appellant existed or not never came to be decided. In any case, according to learned counsel,

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[17] [(1954) 1 SCC 992]

since the activity of providing a corporate guarantee cannot possibly fall within or be acknowledged to be a part of the business activity of the appellant, there would arise no occasion for the same being treated as business profit and thus falling within the ambit of Article 7 of the DTAA.

17. We deem it appropriate to note that the submission advanced on this aspect is noticed only for the purposes of completeness since we have already found, for reasons aforenoted, that it would not be open for us to examine the arguments addressed upon Article 7 of the DTAA.

18. From the undisputed facts which emerge from the record we find that the appellant is a tax resident of the United Kingdom and is stated to be engaged in the manufacture of specialty chemicals. It has also established various subsidiaries across the globe including in India. The guarantee charges are sourced to and an income received by the appellant in lieu of the guarantee that it provides to banks and financial institutions who may have extended credit facilities to its subsidiaries in India. During Financial Year 2010-11, the appellant asserts having extended guarantees to various overseas branches of foreign banks on a global basis in relation to credit facilities extended by those financial institutions to its Indian subsidiaries, namely, Johnson Matthey India Private Limited and Johnson Matthey Chemicals India Private Limited. It is stated to have received guarantee charges aggregating INR 1,49,15,090/- from those subsidiaries. In connection therewith, the appellant and its various Indian subsidiaries executed the **Intra Group Parental Guarantee and Indemnity Services Agreement** on 29 March 2010. For the purposes of appreciating the issues which arise we

deem it apposite to extract the following clauses from that Intra Group Agreement:

> "This AGREEMENT is made on the 29 March 2010 between JOHNSON MATTHEY PLC, a company registered and operating under the laws of England and Wales with its registered office at 40-42 Hatton Garden, London, ECIN 8EE England (the "PROVIDER")
> AND
> JOHNSON MATTHEY INDIA-PRIVATE LIMITED a company registered and operating under the laws of INDIA with its registered office at 103, Ashoka Estate, 24 Barakhamba Road, New Delhi -110001 (the "RECIPIENT").
>
> WHEREAS:
>
> a) The Recipient is engaged in the business of (i) the production of catalyst products (ii) the production of and/or sale of products and provision of services related to precious metals and/or (iii) the development of technology related to (i) and (ii) above or (iv) is a holding company of another company or companies engaged in the business of (i) to (iii) above.
>
> b) The Provider is the ultimate parent company of the Recipient.
>
> c) <u>The Provider is able to provide services to the Recipient in the form of parent company guarantees and counter-indemnification of the Recipient's liabilities, in connection with its business outlined at a) above which the Recipient may wish to avail itself of for its own commercial benefit.</u>
>
> <u>d) The Provider is willing to provide services to the Recipient on the terms and conditions contained in this Agreement.</u>
>
> THE PARTIES THEREFORE AGREE AS FOLLOWS:-
>
> 1) <u>The Provider hereby agrees to make available to the Recipient facilities for the provision company guarantees and counter-indemnification of the Recipient's liabilities ("the Services") as required by the Recipient</u>. The scope of the Services may only be amended by the prior written agreement of both the Provider and the Recipient.
>
> 2) <u>The services will be charged on a quarterly basis</u> and will be calculated on each of 31 March, 30 June, 30 September and 31 December (each a "Quarter Day").

3) <u>The annual rate ("Annual Rate") will be applied in respect of the Recipient's aggregate outstanding balance of parent company guarantees and counter-indemnified obligations as at each Quarter Day</u>.

4) It is the intention of the parties that the Annual Rate satisfy the arm's-length standard. Initially, the Annual Rate shall be 1.125%. The Annual Rate will be reviewed each year, to ensure continued consistency with current arms-length pricing practices and shall be effective from 1 April each year.

5) After each Quarter Day, the Provider shall invoice the Recipient in respect of the Services, on the basis set out in clause 3 above. The Recipient shall ensure that payment is made to the Provider in accordance with the instructions set out on the invoice.

6) This Agreement is effective from 1 April 2009 and shall remain in full force and effect until terminated.

7) In respect of new instances of the provision of the Services, this Agreement shall be terminable by either party giving to the other one month's notice in writing of its intention to terminate the Agreement. However, in respect of outstanding parent company guarantees and counter-indemnified obligations, this Agreement shall continue until there are no longer any such obligations outstanding between the Provider and the Recipient.

8)The Provider shall be entitled to terminate this Agreement forthwith by notice in writing to the Recipient if the Recipient shall:
a) pass a resolution for winding up (otherwise than for the purpose of a bona fide scheme of solvent amalgamation or reconstruction) or a court of competent jurisdiction shall make an order to that effect;
b) make any voluntary arrangement with its creditors or become subject to an administration order;
c) have a receiver or administrative receiver appointed of it or over any part of its undertaking or assets; or
d) any equivalent even occurs under any jurisdiction in which either of the parties are established.

9) If any sum payable by the Recipient under this Agreement is not paid by the due date the Provider shall be entitled to suspend provision of the Services to the Recipient until such time as payment is made.

10) Upon termination of the Agreement, the Provider shall render an account for all unpaid Services plus UK VAT where applicable

to the Recipient and the Recipient shall pay such invoice in accordance with the instructions set out therein.

11) <u>All amounts payable pursuant to this Agreement are exclusive of any sales, business or similar tax other than withholding tax ("WHT") thereon which may be payable in addition on the rendering by the Provider of an appropriate invoice</u>. For the avoidance of doubt, such payments shall be made net of any WHT which may be payable, provided that the Recipient provides to the Provider upon request satisfactory documentary evidence of any deduction of such WHT by the relevant tax authority.

12) All notices which are required to be given hereunder shall be in writing and shall be sent to the address of the Provider or Recipient (as applicable). Any such notice to the Recipient shall be delivered to the address set out in this Agreement or such other address as the Recipient may designate by notice given in accordance with the provisions of this Clause. Any such notice to the Provider may be delivered personally or by first class pre-paid letter to the Group Treasurer, Johnson Matthey PLC, 40-42 Hatton Garden. London, EC1N 8EE, or facsimile transmission. All notices shall be deemed to have been served if by hand when delivered, if by first class post 48 hours after posting and if by facsimile transmission when despatched.

13) None of the parties shall be liable for any delay in performing any of its obligations under this Agreement, if such delay is caused by circumstances beyond the reasonable control of the party so delaying and such party shall be entitled (subject to giving the other full particulars of the circumstances in question and to using its best endeavours to resume full performance without avoidable delay) to a reasonable extension of time for the performance of such obligations.

14) The Recipient may not assign the whole or any part of this Agreement to any third party without the prior written consent of the Provider.
15) The provisions of the Contracts (Rights of Third Parties) Act 1999 shall not apply to this Agreement.

16) This Agreement may be executed in any number of counterparts, each of which, when executed and delivered, shall be an original and all the counterparts together shall constitute one and the same instrument.

17) This Agreement shall be governed by the laws of England and Wales and the parties shall submit to the non-exclusive jurisdiction of the courts of England and Wales."

19. The appellant in its Return of Income, as originally submitted, had characterized the amount of guarantee fee as interest and thus taxable under Article 12 of the DTAA. However, and as was noticed hereinbefore, the AO as well as the DRP held that the sum would be liable to be taxed under Article 23(3) of the DTAA being in the nature of 'other income'. In order to appreciate the contentions that were advanced on this score, Articles 12 and 23 of the DTAA are extracted hereinbelow:

> "**ARTICLE 12 - *Interest*** - *1.* Interest 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 interest may also be taxed in the Contracting State in which it arises and accordingly to the law of that State, provided that where the resident of the other Contracting State is the beneficial owner of the interest the tax so charged shall not exceed 15 per cent of the gross amount of the interest.
>
> *3.* Notwithstanding the provisions of paragraph 2 of this Article:
>
> (*a*) where the interest is paid to a bank carrying on a *bona fide* banking business which is a resident of the other Contracting State and is the beneficial owner of the interest, the tax charged in the Contracting State in which the interest arises shall not exceed 10 percent of the gross amount of the interest;
>
> (*b*) where the interest is paid to the Government of one of the Contracting States or a political sub- division or local authority of that State or the Reserve Bank of India, it shall not be subject to tax by the State in which it arises.
>
> *4.* Notwithstanding the provisions of Article 7 of this Convention and of paragraphs 2 and 3 of this Article :
>
> (*a*) interest arising in India which is paid to any beneficially owned by a resident of the United Kingdom shall be exempt from tax in India if it is paid in respect of a loan made, guaranteed or insured, or any other debt-claim or credit guaranteed or insured by the United Kingdom Export Credits Guarantee Department; and

(*b*) interest arising in the United Kingdom which is paid to and beneficially owned by a resident of India shall be exempt from tax in the United Kingdom if it is paid in respect of a loan made, guaranteed or insured, or any other debt-claim or credit guaranteed or insured by the Export Credits and Guarantee Corporation of India and/or Export-Import Bank of India.

5. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11 (Dividends) of this Convention.

6. The provisions of paragraphs 1, 2 and 3(*a*) of this Article shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be shall apply.

7. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by that permanent establishment or fixed base, then such interest shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each

Contracting State, due regard being had to the other provisions of this Convention.

9. Any provision in the laws of either Contracting State relating only to interest paid a non-resident company shall not operate so as to require such interest paid to a company which is a resident of the other Contracting State to be treated as a distribution or dividend by the company paying such interest or to be left out of account as a deduction in computing the taxable profits of the company paying the interest. The preceding sentence shall not apply to interest paid to a company which is a resident of one of the Contracting State in which more than 50 per cent of the voting power is controlled, directly or indirectly, by a person or persons who are residents of the other Contracting State.

10. The relief from tax provided for in paragraph 2 of this Article shall not apply if the beneficial owner of the interest :

(*a*) is exempt from tax on such income in the Contracting State of which he is a resident and

(*b*) sells or makes a contract to sell the holding from which such interest is derived within three months of the date such beneficial owner acquired such holding.

11. The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.

xxxx xxxx xxxx

ARTICLE 23 - Other income - 1. Subject to the provisions of paragraph 2 of this Article, items of income beneficially owned by a resident of a Contracting State, wherever arising, other than income paid out of trusts or the estates of deceased persons in the course of administration, which are not dealt with tin the foregoing Articles of this Convention, shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated the therein, and the right or property in respect of which the income is paid is effectively connected with such permanent

establishment or fixed base. In such case, the provisions of Article 7 or Article 15 of this Convention, as the case may be, shall apply.

3. Notwithstanding the provisions of paragraphs 1 and 2 of this Article, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention, and arising in the other Contracting State may be taxed in that other State."

20. Insofar as the issue of guarantee charges being viewed as interest under Article 12 of the DTAA is concerned, we note that the expression 'interest' is defined by Article 12(5) to mean income from "debt-claims of every kind" irrespective of whether they be secured by a mortgage or carry a right to participate in the debtor's profit. It becomes pertinent to note that the guarantee charges were not received by the appellant in respect of any debt owed to it by its Indian subsidiary. It also cannot possibly be acknowledged to be income derived from claims that the appellant may have had against its Indian subsidiaries. As per its own stated case, the guarantee charges were received in connection with the credit facilities which were extended by the overseas branches of foreign banks to its Indian subsidiaries. Since the appellant appears to have guaranteed the repayment of the loans so extended to its subsidiaries, it received charges as per the stipulations contained in the Intra Group Agreement noticed above. The aforesaid arrangement and its underlying premise is clearly evident from the recitals of that agreement extracted in the preceding parts of this judgment.

21. In our considered opinion insofar as this question is concerned, the Tribunal has correctly found that the appellant was neither a party to the loan agreements that may have been executed nor was there any privity of contract that could be said to exist. It was the aforesaid undisputed facts which weighed upon the Tribunal to hold that the

payments received by the appellant would not fall under Article 12 of the DTAA.

22. We find no reason to differ from the view as expressed by the Tribunal bearing in mind the aforenoted undisputed facts. As was observed hereinbefore, the guarantee charges that the appellant received was a remuneration for the assurance that it had offered to lending entities and who may have extended credit facilities to its Indian subsidiaries. The debt that it owed was to those financial institutions. It would be those institutions which could have a claim against the appellant. The Intra Group Agreement also did not envisage any claims that the appellant could have laid against its own subsidiaries in the eventuality that they were to default. The Indian subsidiaries owed no debt to the appellant and which would have enabled us to recognise the guarantee charges as income derived from a debt or a claim and which constitutes the determinative factor for the purposes of examining the applicability of Article 12 of the DTAA. As is manifest from a reading of the Intra Group Agreement, the guarantee charges were levied for the service of providing parent company guarantees and counter-indemnification of the liabilities of the Indian subsidiaries. On an overall conspectus of the aforesaid we find ourselves unable to countenance the guarantee charges as being liable to be viewed as 'interest' under Article 12 of the DTAA.

23. It becomes pertinent to note that the assertion of guarantee charges being interest would also not sustain even when tested on the anvil of Section 2(28A) of the Act and which reads as under:

> “"interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or

other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized"

24. As is manifest from the above, the expression interest is defined to mean amounts payable in respect of any monies borrowed or debts incurred. Undisputedly the appellant had not borrowed any monies. The debt, if any, which could be said to have been incurred was clearly not one owed to the Indian subsidiaries. The income that it received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall the appellant in case its Indian subsidiaries were to default in their repayment obligations. It thus becomes apparent that the guarantee fee would neither fall within the ambit of Article 12 of the DTAA nor Section 2(28A) of the Act.

25. That then takes us to the submission of the said income not being liable to be viewed as having arisen or accrued in India. It becomes pertinent to note that the expressions 'accrue' and 'arise' as appearing in Section 5 of the Act have arisen for interpretation on more than one occasion. In *E.D. Sassoon* the aforesaid expressions were explained as follows:

> "**34.** The question still remains whether the remuneration for the broken periods accrued to the Sassoons and the contention which was strenuously urged before us on behalf of the transferees was that the Sassoons had rendered the services in terms of the managing agency agreements to the respective Companies, that the services thus rendered were the source of income and whatever income could be attributed to those services was earned by the Sassoons and accrued to them in the chargeable accounting period though it was ascertained and paid in the year 1944 to the transferees.
>
> **35.** The word "earned" has not been used in Section 4 of the Income Tax Act. The section talks of "income, profits and gains" from whatever source derived which (*a*) are received by or on behalf of the assessee, or (*b*) accrue or arise to the assessee in the taxable territories during the chargeable accounting period. Neither the word "income" nor the words "is received", "accrues" and

"arises" have been defined in the Act. The Privy Council in *CIT* v. *Shaw, Wallace & Co.* [*CIT* v. *Shaw, Wallace & Co.*, 1932 SCC OnLine PC 16 : (1931-32) 59 IA 206 : ILR (1932) 59 Cal 1343 at p. 1352 (PC)] at ILR p. 1352 attempted a definition of the term "income" in the words following : (IA pp. 212-13)

> "Income, their Lordships think, in the Indian Income Tax Act, connotes a periodical monetary return 'coming in' with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall."

Mukerji, J. has defined these terms in *Rogers Pyatt Shellac & Co.* v. *Secy. of State for India* [*Rogers Pyatt Shellac & Co.* v. *Secy. of State for India*, 1924 SCC OnLine Cal 67: ILR (1925) 52 Cal 1 : (1924) 1 ITC 363 at p. 371] at ITC p. 371 : (ILR pp. 29-31)

> "Now what is income? The term is nowhere defined in the Act. … In the absence of a statutory definition we must take its ordinary dictionary meaning—"that which comes in as the periodical produce of one's work, business, lands or investments (considered in reference to its amount and commonly expressed in terms of money); annual or periodical receipts accruing to a person or corporation" (*Oxford Dictionary*).
>
> The word clearly implies the idea of receipt, actual or constructive. The policy of the Act is to make the amount taxable when it is paid or received either actually or constructively. 'Accrues', 'arises' and 'is received' are three distinct terms. So far as receiving of income is concerned, there can be no difficulty; it conveys a clear and definite meaning, and I can think of no expression which makes its meaning plainer than the word 'receiving' itself. The words 'accrue' and 'arise' also are not defined in the Act. The ordinary dictionary meanings of these words have got to be taken as the meanings attaching to them. 'Accruing' is synonymous with 'arising' in the sense of springing as a natural growth or result. The three expressions 'accrues', 'arises' and 'is received' having been used in the section. Strictly speaking 'accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing or growing up by way of addition or increase or as an accession or advantage; while the word 'arises' means comes into existence or notice or presents itself. The former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. It is difficult to say that this distinction has

> been throughout maintained in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases. It is clear, however, as pointed [out] by Fry, L.J. in *Colquhoun (Surveyor of Taxes)* v. *Brooks* [*Colquhoun (Surveyor of Taxes)* v. *Brooks*, (1888) LR 21 QBD 52 at p. 59 (CA) : (1889) LR 14 AC 493 (HL)] (QBD at p. 59) (this part of the decision not having been affected by the reversal of the decision by the Houses of Lords), <u>that both the words are used in contradistinction to the word "receive" and indicate a right to receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate</u>.
>
> One other matter need be referred to in connection with the section. What is sought to be taxed must be income and it cannot be taxed unless it has arrived at a stage when it can be called 'income'."

36. The observations of Fry, L.J. quoted above by Mukerji, J. were made in *Colquhoun (Surveyor of Taxes)* v. *Brooks* [*Colquhoun (Surveyor of Taxes)* v. *Brooks*, (1888) LR 21 QBD 52 at p. 59 (CA) : (1889) LR 14 AC 493 (HL)] , while construing the provisions of 16 and 17 Victoria Chapter 34 Section 2 Schedule "D". The words to be construed there were "profits or gains, arising or accruing" and it was observed by Fry, L.J. at QBD p. 59:

> "In the first place, I would observe that the tax is in respect of 'profits or gains arising or accruing'. I cannot read those words as meaning 'received by'. If the enactment were limited to profits and gains 'received by' the person to be charged, that limitation would apply as much to all Her Majesty's subjects as to foreigners residing in this country. The result would be that no income tax would be payable upon profits which accrued but which were not actually received, although profits might have been earned in the kingdom and might have accrued in the kingdom. I think, therefore, that the words 'arising or accruing' are general words descriptive of *a right to receive profits*."

37. To the same effect are the observations of Satyanarayana Rao, J. in *CIT* v. *Anamallais Timber Trust Ltd.* [*CIT* v. *Anamallais Timber Trust Ltd.*, 1949 SCC OnLine Mad 336 : (1950) 18 ITR 333 at p. 342 (Mad)] at ITR p. 342 and Mukherjea, J. in *CIT* v. *Ahmedbhai Umarbhai & Co.* [*CIT* v. *Ahmedbhai Umarbhai & Co.*, 1950 SCC 94 at p. 104 : (1950) 18 ITR 472 : 1950 SCR 335 at p. 389] at SCR p. 389 where this passage from the judgment of Mukerji, J. in *Rogers Pyatt case* [*Rogers Pyatt Shellac & Co.* v. *Secy. of State for India*, 1924 SCC OnLine Cal 67

: ILR (1925) 52 Cal 1 : (1924) 1 ITC 363 at p. 372] at ITC p. 372 is approved and adopted. It is clear therefore that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed *debitum in praesenti, solvendum in futuro*; see *W.S. Try Ltd.* v. *Johnson (Inspector of Taxes)* [*W.S. Try Ltd.* v. *Johnson (Inspector of Taxes)*, (1946) 1 All ER 532 at p. 539 (CA)] , All ER at p. 539 and *Webb* v. *Stenton* [*Webb* v. *Stenton*, (1883) LR 11 QBD 518 at pp. 522 and 527 (CA)] , QBD at pp. 522 and 527. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him

38. The word "earned" even though it does not appear in Section 4 of the Act has been very often used in the course of the judgments by the learned Judges both in the High Courts as well as the Supreme Court. (Vide *CIT* v. *Ahmedbhai Umarbhai & Co.* [*CIT* v. *Ahmedbhai Umarbhai & Co.*, 1950 SCC 94 at p. 124 : (1950) 18 ITR 472 at p. 502 : 1950 SCR 335] at SCR p. 364 and *CIT* v. *Thiagaraja Chetty & Co.* [*CIT* v. *Thiagaraja Chetty & Co.*, (1953) 2 SCC 353 at pp. 360-61 : (1953) 24 ITR 525 at p. 533 (SC)] at ITR p. 533). It has also been used by the Judicial Committee of the Privy Council in *Commissioners of Taxation* v. *Kirk* [*Commissioners of Taxation* v. *Kirk*, 1900 AC 588 at p. 592 (PC)] at AC p. 592. The concept however cannot be divorced from that of income accruing to the assessee. If income has accrued to the assessee it is certainly earned by him in the sense that he has contributed to its production or the parenthood of the income can be traced to him. But in order that the income can be said to have accrued to or earned by the assessee it is not only necessary that the assessee must have contributed to its accruing or arising by rendering services or otherwise but he must have created a debt in his favour. A debt must have come into existence and he must have acquired a right to receive the payment. Unless and until his contribution or parenthood is effective in bringing into existence a debt or a right to receive the payment or in other words a *debitum in praesenti, solvendum in futuro* it cannot be said that any income has accrued to him. The mere expression "earned" in the sense of rendering the services, etc. by itself is of no avail."

26. The very same question arose yet again for the consideration of the Supreme Court in **Seth Pushalal Mansinghka (P) Ltd. v. CIT**[18]. While reiterating the fundamental principles enunciated in *E.D. Sassoon*, the Supreme Court pertinently observed:

> **5.** The question to be considered in this case is : Where did the income or the right to receive the payment under the contracts of sale accrue or arise? According to the *Oxford English Dictionary* the meaning of the word "accrue" is "to fall as a natural growth or increment; to come as an accession or advantage". The word "arise" is defined as "to spring up, to come into existence". The word "receive" is not used in the same sense as "accrue" and "arise" in para 4(1)(*iii*) of Part B States (Taxation Concession) Order. The words "accrue" and "arise" do not mean actual receipt of the profits or gains. Both these words are used in contradistinction to the word "receive" and indicate a right to receive. In *Colquhoun* v. *Brooks* [(1888) 21 QBD 52 at 59] Lord Justice Fry had to construe the expression "profits or gains, arising or accruing" in 16 and 17 Victoria Chapter 34, Section 2, Schedule 'D' and observed in that connection as follows:
>
> > "In the first place, I would observe that the tax is in respect of 'profits or gains arising or accruing'. I cannot read those words as meaning 'received by'. If the enactment were limited to profits and gains 'received' by the person to be charged, that limitation would apply as much to all Her Majesty's subjects as to foreigners residing in this country. The result would be that no income tax would be payable upon profits which accrued but which were not actually received, although profits might have been earned in the kingdom and might have accrued in the kingdom. I think, therefore, that the words 'arising or accruing' are general words descriptive of a right to receive profits."
>
> It is clear, therefore, that the income may accrue to an assessee without actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to accrue to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income.— (See *E.D. Sassoon and Company Ltd.* v. *CIT* [26 ITR 27, 51]).

27. As would be evident from a reading of the principles enunciated in the aforenoted two decisions the expression 'arise' or 'accrue' were interpreted to mean a periodical monetary return being received with

[18] [1967 SCC OnLine SC 222]

some regularity. In the context of the Act, it was held that income accruing would not be dependent upon actual receipt but would be governed by the principle of a 'right to receive'. The Supreme Court also observed that the Act consciously avoids using the word 'received'. It was accordingly, held that the moment a right to receive came into existence, income would be deemed to have arisen or accrued.

28. This principle was succinctly explained by the Allahabad High Court in **M.K. Brothers Private Limited vs. Commissioner of Income Tax, U.P.**[19] in the following terms:

> "**4.** The deduction or exclusion, which is the subject-matter of question No. 1, is for the purpose of ascertaining profits of the assessee and the deduction, which is the subject-matter of question No. 2, is for ascertaining disbursements made out of profits. In the one case the amount was not the income at all of the assessee; in the other case it was, but has to be deducted out of the taxable income. "Accrue" means "to arise or spring as a natural growth or result": vide *Murray's Dictionary*. It is stated in *Words and Phrases*, vol. 1, page 594, that the word means "coming as a natural accession or result; arising in due course" and tax accrues when all events have occurred which fix its amount and determine the taxpayer's liability to pay it. The meanings given to the word at pages 594, 596 and 601 are "due and payable", "possession of a present enforceable right", "fixed" and "realised". In *Commissioner of Income-tax* v. *Bansilal Motilal* [A.I.R. 1930 Bom. 381.] the word was interpreted to indicate "some origin or source of growth for the income in question", as opposed to actual receipt. In *Rogers Pyatt Shellac & Co.* v. *Secretary of State for India* [[1924] 1 I.T.C. 363, 372.] Mukerji J. said as follows:
>
> > "… 'accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing up by way of addition or increase or as an accession or advantage; while the word 'arises' means comes into existence or notice or presents itself. The former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable………both the words are used in contradistinction to the word 'receive' and

[19] 1966 SCC OnLine All 438

indicate a right to receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate….”

5. These observations were adopted in *V. Ramaswami Naidu* v. *Commissioner of Income-tax* [[1959] 35 I.T.R. 33.] and *E.D. Sassoon & Co. Ltd.* v. *Commissioner of Income-tax* [[1954] 26 I.T.R. 27; [1955] 1 S.C.R. 313.] . In the latter case Bhagwati J. said at page 51:

> “If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody.”

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7. *Commissioner of Income-tax* v. *Shoorji Vallabhdas & Co.* [[1962] 46 I.T.R. 144, 148 (S.C.).] , *Commissioner of Income-tax* v. *Chamanlal Mangaldas & Co.* [[1956] 29 I.T.R. 987.] and *Commissioner of Income-tax* v. *Harivallabhadas Kalidas & Co.* [[1960] 39 I.T.R. 1; [1960] 3 S.C.R. 50.] lay down that there is no accrual of income if it is surrendered or relinquished by an agreement before it could accrue.

8. Every income that accrues (or arises) is liable to be taxed; it follows that it is liable to be taxed regardless of its destination or disposal or what happens afterwards. No treatment meted out to an income after it has accrued (or arisen) can affect its liability to be taxed; this is well settled. In *Nizam's Guaranteed Stale Railway Co.* v. *Wyatt* [(1890) 2 Tax Cas. 584, 590.] , *Pollock B.* approved of the following statement:

> “When once the thing is ascertained as being subject to income-tax it matters not what is done with it afterwards. When once it has come within the grasp of the Income Tax Acts it is liable to income-tax whatever may be its destination or whatever use it may be put to.”

xxxx **xxxx** **xxxx**

21. In accordance with the law stated above the following have been held to be income accrued or arisen:

(1) annual payment received by an assessee under a guarantee, though it was to be applied in paying interest on capital furnished by the assessee: *Nizam's Guaranteed State Railway Co.* [(1890) 2 Tax Cas. 584.] ;

(2) full salary received by an assessee, though part of it was not actually received and was retained by his employer for being

credited to a compulsory deposit fund: *Bell* [(1903) 4 Tax Cas. 522.] ;

(3) a sum credited by an employer to the account of the assessee-employee under the provident fund scheme, though no part of it was payable to the assessee so long as he continues in service and he could not raise money on it: *Smyth* [(1904) 5 Tax Cas. 36.] ;

(4) income from dividends on shares purchased by an assessee through a loan taken from a creditor and handed over to it with an obligation to adjust it towards the payment of interest on the loan and part of the principal loaned: *Paterson* [(1924) 9 Tax Cas. 163.] ;

(5) income from property, though it was paid as maintenance allowance to dependants under a decree of court (without the maintanance being a charge upon the property yielding the income): *Sitaldas Tirathdas* [[1961] 41 I.T.R. 367; [1961] 3 S.C.R. 634.] ;

(6) income received by an assessee from property bequeathed to him by its previous owner with a direction to spend for obtaining probate of the will and on his *shradh* ceremony expenses: *P.C. Mullick* v. *Commissioner of Income-tax* [[1938] 6 I.T.R. 206 (P.C.).] ;

(7) royalty due from a lessee, though the lessee was to retain and apply it towards adjustment of the debt due to him from the assessee: *Manager of Katras Encumbered Estate* [[1934] 2 I.T.R. 100.] ;

(8) profit arising out of a partnership assigned for a certain term to relations under a deed of settlement: *K.A. Ramachar* v. *Commissioner of Income-tax* [[1961] 42 I.T.R. 25; [1961] 3 S.C.R. 380.] ; and

(9) dividend assigned by the holder of the shares to his wife for the future, while the shares remained in the assessee's name: *Provat Kumar Mitter* v. *Commissioner of Income-tax* [[1961] 41 I.T.R. 624; [1961] 3 S.C.R. 37.] .

22. And the following have been held not to be income accrued or arisen:

(1) income received from property charged under a court's decree with maintenance allowance to a dependant and spent on the maintenance: *Bejoy Singh Dudhuria* [[1933] 1 I.T.R. 135 (P.C.).] and *Commissioner of Income-tax* v. *D.R. Naik* [[1939] 7 I.T.R. 362.] ;

(2) income from trust property which under the trust deed was to be spent on the maintenance of the assessee and his wife: *Commissioner of Income-tax* v. *Manilal Dhanji* [[1962] 44 I.T.R. 876 (S.C.).] ;

(3) part of income from a partnership which under an agreement was to be paid to those contributing towards the investment of the assessee: *Ratilal B. Daftary* [[1959] 36 I.T.R. 18.] ;

(4) a part of the commission given up under a contract before it accrued: *Harivallabhadas Kalidas & Co.* [[1960] 39 I.T.R. 1; [1960] 3 S.C.R. 50] and *Shoorji Vallabhdas & Co.* [[1962] 46 I.T.R. 144 (S.C.).] and

(5) amount credited by the assessee under the licence towards a certain fund for the purpose of returning it to the consumers: *Poona Electric Supply Co. Ltd.* [[1965] 57 I.T.R. 521 (S.C.).] .

xxxx **xxxx** **xxxx**

24. Under the contract between the Corporation and the assessee, the Corporation became liable to pay, and the assessee became entitled to receive, commission at a certain rate every year. The disputed amount is undoubtedly out of the commission earned by the assessee for the previous year relating to the assessment year. It was after it had been earned by it that it became liable to be retained by the Corporation for adjustment of the debt due to it from Sharma and Company. The disputed amount was used by the Corporation to reduce the debt due to it from Sharma and Company; it got the right to do so on account of a condition in the contract that it could retain part of the commission for the purpose. Under one part of the contract the assessee became entitled to the commission, i.e., the commission accrued to it and, by a subsequent condition, the Corporation became entitled to retain and adjust it towards the debt due to it. By this adjustment the debt due from the assessee to Sharma and Company got automatically adjusted. It was thus clearly a case of application of income after accrual and not of diversion before or at accrual. The Corporation's right itself depended upon the assessee's earning the commission. The commission was payable to the assessee but, instead of its being paid to it, was to be retained by the Corporation. So the commission accrued first to the assessee and then it was retained. It was not that the commission did not accrue at all to the assessee. The contract makes it clear that the whole commission at the rate of Rs. 1.75 per cent. was to accrue annually and that the amount to be retained was to come out of it. There is not a word in any of the contracts and the letters to suggest that the amount to be retained was not to accrue at all. If it did not accrue, there could be no question of its being retained or of its being adjusted. If it did not accrue, it remained the money of the Corporation. The commission was to be paid by the Corporation out of its own money; so what was not payable as commission remained its money. If it were said that the disputed amount did not accrue as commission, it would mean that it remained the. Corporation's money, but then it could

> not be used for discharge of the debt due to it. If it could be used in discharge of the debt due to it, it necessarily follows that it had accrued as commission and become payable to the assesses. It is of no consequence that the right to the commission arose from a contract which itself conferred the right of retention upon the Corporation. The right to an income and the obligation to spend it on a particular object do not make out a case of diversion simply because they are incorporated in the same document because the document can make it clear that the obligation is to spend the income after it has accrued. If the obligation is to spend money out of the accrued income it is a case of application, and not of diversion, and the obligation can be imposed by the same document by which the right is conferred."

That decision ultimately came to be affirmed by the Supreme Court in **M.K Brothers Private Limited vs. Commissioner of Income Tax, Kanpur**[20].

29. When tested on the aforesaid precepts, we find no hesitation in holding that the income in the form of guarantee charges had in fact accrued and arisen in India. The guarantee charges clearly answered to the description of income accruing and which was explained by the Supreme Court to constitute *"a periodical monetary return 'coming in' with some sort of regularity, or expected regularity, from definite sources"*. As we view the Intra Group Agreement, it becomes evident and apparent that the foundational source of those payments was the appellant's agreement to provide the service of parent company guarantees and counter indemnification facilities. These were services offered to the Indian subsidiaries to avail for their *"own commercial benefit"*. The charge was envisaged to be levied on a quarterly basis and the annual rate at the time of execution of the Intra Group Agreement was prescribed to be 1.125%. The annual rate was to levied

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[20] (1973) 3 SCC 30

on the "Recipient's" [the Indian subsidiaries] *"outstanding balance of parent company guarantees and counter-indemnification obligations as at each Quarter Day"*.

30. It is thus evident that the guarantee charges became leviable every quarter at a rate already agreed upon by parties and on the outstanding balance. Thus, not only was the payment ordained to come from a specified source, it was also envisaged to become payable with sufficient regularity. The payment was to be invoiced every Quarter Day and liable to be paid as per the instructions of the appellant. The Intra Group Agreement also provisioned for consequences which would ensue in case the Indian subsidiary were to default in payment of those charges by stipulating that in such an event, it would be open to the appellant to suspend the provision of services. Thus, in case the Indian subsidiary were to fail to honor any invoice raised in respect of guarantee charges, it would have been open for the appellant to discontinue the service of extending guarantees.

31. The guarantee charges were thus anchored to the Intra Group Agreement and were indelibly connected with the extension of services by the appellant in India for the benefit of its subsidiaries. The arrangement between the parties was independent of any other legal obligation or liability which the appellants may have taken over or owed to a lending institution. The only parties to this agreement were the appellants and their corresponding Indian subsidiary. The obligation to pay was incurred in India, was in respect of services utilized in India and was agreed to arise with regularity as per the stipulations forming part of the Intra Group Agreement.

32. While it may be true that if the Indian subsidiaries were to default, the financial institutions may be compelled to adopt measures of recourse against the assets of the appellant situated overseas, however, that in our considered opinion cannot be viewed as being either relevant or determinative of the Section 5 question. The guarantee charges stood determined and payable in terms of the Intra Group Agreement noticed hereinabove. The said charges were payable irrespective of a default or a failure on the part of the Indian subsidiary to discharge its obligations to the financial institution from which it may have received credit. The charge was in a sense recompense for the service provided by the appellant in extending a guarantee to overseas financiers who may have extended credit facilities to its Indian subsidiaries and the assurance of repayment proffered to them by the appellant. Regard must also be had to the fact that the appellant had not extended any credit or lent capital to its Indian subsidiaries. The guarantee charges were solely on account of the appellant having guaranteed repayment of debts owed to third parties by the Indian subsidiaries. The source and fountainhead of the receipt was thus indelibly connected and confined to the Intra Group Agreement and the obligations of the appellant in connection therewith.

33. It becomes pertinent to note that taxability of income is concerned solely with income accruing or arising. It is clearly not concerned with the ultimate destination of that income or the use to which it may be put. That the guarantee charges may be utilized by the appellant to meet its liabilities to overseas financial institutions would be wholly irrelevant for the purposes of examining whether income had arisen or accrued in India. As was pithily observed by the Supreme

Court in **Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT**[21], the Act is not concerned with destination or utilisation. It is focused on the aspect of income having arisen or accrued. We deem it apposite to extract the following passage from that decision:-

> "**23.** There is another aspect of this matter. The Company, in this case, is at liberty to use the interest-income as it likes. It is under no obligation to utilise this interest-income to reduce its liability to pay interest to its creditors. It can reinvest the interest-income in land or shares, it can purchase securities, it can buy house property, it can also set up another line of business, it may even pay dividends out of this income to its shareholders. There is no overriding title of anybody diverting the income at source to pay the amount to the creditors of the company. It is well settled that tax is attracted at the point when the income is earned. Taxability of income is not dependent upon its destination or the manner of its utilisation. It has to be seen whether at the point of accrual, the amount is of revenue nature. If so, the amount will have to be taxed. (*Pondicherry Rly. Co. Ltd.* v. *CIT* [AIR 1931 PC 165 : 1931 All LJ 481 : 58 IA 239])"

34. As we examine the facts that obtain, we come to the firm conclusion that the guarantee charges were founded principally and solely upon the Intra Group Agreement and consequently the right to receive was also based on that agreement. The ultimate impact of any guarantee extended or any adverse consequence which the appellant may ultimately face or bear would not be determinative of the question of where the income had arisen or accrued.

35. Much emphasis was laid by the appellant on the judgment rendered by the Mumbai Bench of the Tribunal in *Capgemini* and where the Tribunal had while examining a similar transaction held that guarantee commission could not be said to have arisen or accrued in India. We find ourselves unable to endorse the view taken by the Tribunal for the following reasons. Firstly, the decision appears to

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[21] (1997) 6 SCC 117

proceed on a mere ipse dixit that "from the record" the guarantee commission did not accrue or arise in India. The Tribunal then takes the position that since the guarantee was given by a French assessee to a bank situate in that country, income could not be said to have arisen or accrued in India.

36. We find ourselves unable to agree with the view taken in *Capegemini* bearing in mind the facts of the present case and where undisputedly the guarantee charges were not founded on any contract that the appellant may have had with a foreign bank but sourced and indelibly tied to the Intra Group Agreement. The consequences which may ensue if the guarantee were to be enforced and its resultant impact on its overseas assets are clearly not factors germane for answering the question of where the income arose or accrued.

37. While on decisions handed down by Tribunals' we take note of the following contrarian view which was taken in **Lease Plan India Pvt. Ltd. Vs. Deputy Commissioner of Income Tax**[22] while dealing with an identical question: -

> "**19.** Thus we examine the facts whether the Guarantee Fee paid by assessee to its AE in Netherlands can be considered as 'interest' in terms of Article 11 of the DTAA. It defines interest as
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> > "*6.* The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage, but not carrying a right to participate in the debtor's profits, and in particular, income from the Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article."
>
> Broadly, all income earned from the 'provision of capital' by way of 'debt claim' constitutes interest and provision of capital in the

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'non debt form', generally, constitutes 'dividend'. Therefore, to consider the income as 'interest', firstly, there should be 'debt' and there should be a 'claim' on that debt and 'form' which income should arise to qualify as 'interest'. Thus, two criteria need to be satisfied:—

(1) 'provision of capital' and

(2) It should be in the form of debt claim.

In the present case apparently, AE has not provided any capital to the appellant on which income is earned. It is a corporate guarantee, being a surety to the lender bank of the appellant that, if in a case, in future, the appellant fails to pay the due amount owed to those lenders, the Netherland Company will pay to those lenders. Thus, there was promise to reimburse the amount to those lenders on happening of an event i.e. failure of payments by the appellant of the dues owed to the lenders and lenders invoking the guarantee issued by the Netherlands company in favour of those lenders. Therefore it needs to examine whether there is any provision of capital by the Netherland Company to Indian Company appellant, answer is in negative. Further, there should be a "debt claim and 'form' such claim income should arise to qualify as 'interest'. Thus the word 'debt claim "predicate the existence of debtor-creditor relationship [lender-borrower]. That relationship can arise only when there is a provision of capital. In view of this, we hold that guarantee fee paid by the assessee to Netherlands company, in the above facts, cannot be covered in the definition of interest as per Article 11 of the DTAA. Hon Bombay High court in Commonwealth Development Corporation

20. Further, we have perused decision of the *Container Corporation* v. *Commissioner of Internal Revenue of United States Tax Court Report*, [134 T.C. 122 (U.S.T.C. 2010) 134 T.C. 5 Decided Feb 17, 2010]. On careful consideration of the decision of that court, the issue before the Court was whether the guarantee fee paid towards guaranteeing debt of a subsidiary company is "interest" or a "service". The court came to conclusion that guarantee are more analogous to services, like services, are produced by the obligee. It further held that in holding the guarantee fee as interest has too many shortcomings, as it does not approximate the interest on a loan. **It is merely a promise to possibly perform a future act and there was no obligation to pay immediately.** Thus, the court held that guarantee fee cannot be considered as an interest. However it was held to be a service. In view of this we hold that in absence of provision of capital and any debt claim between the parties the impugned guarantee fees paid by the appellant to the Netherlands based company cannot be held to be "interest" in terms of Article 11 of the DTAA."

38. We, consequently, answer the two questions which stand posited in the negative and against the appellant. The issue of whether guarantee charges would constitute business income and fall within the ken of Article 7 of the DTAA is kept open to be addressed in an appropriate case.

39. The appeals shall consequently stand dismissed.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

MAY 28, 2024/kk