IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 08.08.2025

DELIVERED ON : 25.11.2025

CORAM :

THE HONOURABLE MR. MANINDRA MOHAN SHRIVASTAVA,
CHIEF JUSTICE
AND
THE HONOURABLE MR.JUSTICE SUNDER MOHAN

TCA Nos.277 to 280 of 2016

Cognizant Technology Solutions
India Private Limited
38, Whites Road, 3rd Floor,
Chennai – 600 014
Now at No.165/110
Menon Eternity Building
6th Floor, St. Mary's Road
Alwarpet, Chennai – 600 018.

Appellant(s)
in both appeals

Vs

Commissioner of Income Tax
Large Taxpayer Unit, Chennai
1775, Jawaharlal Nehru Inner Ring Road
Anna Nagar Western Extension
Chennai – 600 101.

Respondent(s)
in both appeals

PRAYER: Appeals under Section 260A of the Income-tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras "C" Bench, dated 30.9.2015 in ITA.Nos.209/Mds/2007; in CO No.47/Mds/2007 in ITA No.591/Mds/2007; in ITA No.591/Mds/2007, in ITA No.2536/Mds/2007, respectively.

For Appellant(s): Mr.N.V.Balaji

For Respondent(s): Mr.Karthik Ranganathan
Senior Standing Counsel

COMMON JUDGMENT

THE CHIEF JUSTICE

Impugning the common order dated 30.9.2015 passed by the Income Tax Appellate Tribunal [ITAT], the assessee has filed these appeals pertaining to assessment years 2003-2004 and 2004-2005, which have been admitted on the following substantial questions of law:

T.C.A.No.277 of 2016:

> *"(i) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the losses of the software technology park units of the appellant cannot be set off against the income from other units in arriving at total income?*
> *(ii) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was*

right in holding that amounts paid by the appellant to M/s.Sprint USA, for International Private Leased Circuits (IPLC) is to be disallowed under Section 40(a)(i) of the Act?

(iii) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that amounts paid by the appellant to M/s.Sprint USA, for International Private Leased Circuits (IPLC) is 'royalty' under Section 9 of the Act read with the Double Taxation Avoidance Agreement between India and United States of America?

(iv) Whether under the facts and circumstances of the case, the amounts paid by the appellant to M/s.Sprint USA towards IPLC should be subject to deduction of tax at source considering the non discrimination Article of the Double Taxation Avoidance Agreement between India and United States of America? and

(v) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal has erred in not adjudicating the ground of appeal raised by the appellant with respect to claim of tax holiday deduction under Section 10A/10B on miscellaneous income?"

TCA No.278 of 2016:

(i) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that amounts paid by the appellant to M/s.Sprint USA, for International Private Leased Circuits (IPLC) is to be disallowed under Section 40(a)(i) of the Act?

(ii) Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that amounts paid by the appellant to M/s.Sprint USA, for International Private Leased Circuits (IPLC) is 'royalty' under Section 9 of the Act read with the Double Taxation Avoidance Agreement between India and United States of America? And

(iii) Whether under the facts and circumstances of the case, the amounts paid by the appellant to M/s.Sprint USA towards IPLC should be subject to deduction of tax at source considering the non discrimination Article of the Double Taxation Avoidance Agreement between India and United States of America?

T.C.A.No.279 of 2016

Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in

holding that the appellant is liable for interest under Section 234D of the Act?

T.C.A.No.280 of 2016:

Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the losses of the software technology park units of the appellant cannot be set off against the income from other units in arriving at total income?

2. It behooves us to give a recount of the factual matrix that propelled the assessee to file these appeals.

2.1. The assessee is a company engaged in the business of software development and export. The return filed by the assessee was processed under Section 143(1) of the Income-tax Act, 1961 [the Act] and, subsequently, selected for scrutiny by issue of notice under Section 143(2) of the Act. The Assessing Officer completed the assessment of income of the assessee under Section 143(3) of the Act for the assessment years 2003-2004 and 2004-2005 vide orders dated 28.2.2006 and 18.12.2006, respectively, thereby

denying the claim of the assessee for set off of current year losses of assessee's Pune, Chennai I and Kolkata II units for the assessment years 2003-2004 and that of the Bangalore unit for the assessment year 2004-2005 on the ground that these units are Software Technology Parks in India [STPI] registered units claiming exemption under Section 10A/10B of the Act.

2.2. Apropos of assessment year 2003-2004, the Assessing Officer finding that the amount paid by the assessee to Sprint USA, for International Private Leased Circuits (IPLC), was without deduction of tax at source, disallowed it under Section 40(a)(i) of the Act. For the said assessment year, the Assessing Officer also denied claim of tax holiday deduction under Section 10A/10B of the Act on miscellaneous income.

2.3. In view of the rejection of the aforesaid claims for set off of loss, tax holiday deduction on miscellaneous income and deduction of expenditure, the Assessing Officer raised demand on the assessee, including interest under Sections 234B and 234D of

the Act for both the years.

2.4. Assailing the assessment orders, the assessee approached the Commissioner of Income Tax (Appeals) [CIT(A)] by filing appeals. The CIT(A) rejected the appeal in so far as the claim for set off of losses of the Pune, Chennai I and Kolkatta II units of the assessee for the assessment year 2003-2004 and that of Bangalore unit for the assessment-year 2004-2005. The disallowance of the claim of the assessee qua payments made to Sprint USA for the assessment year 2004-2005 made by the Assessing Officer was affirmed by the CIT(A). The CIT(A) also upheld the order of the Assessing Officer on the issue of claim of tax holiday deduction on miscellaneous income, however, with a direction to the Assessing Officer to verify whether the miscellaneous income, in so far as it relates to sale of scrap has direct nexus with the eligible undertaking or not. The challenge made by the assessee to the interest claimed under Section 234B of the Act was rejected. However, in respect of interest under Section 234D of the Act, the CIT(A) relied upon an earlier decision of ITAT

and allowed the ground of appeal for the assessment year 2003-2004 and dismissed the claim for the assessment year 2004-2005.

2.5. Assailing the orders passed by the CIT(A), the assessee as well as the revenue filed appeals before the ITAT. With respect to the issue of disallowance of payments made to Sprint, USA, the assessee preferred a cross objection for the assessment year 2003-2004.

2.6. The ITAT, vide the common impugned order for both the assessment years, dismissed the grounds of appeal of the assessee on the issue of set off of losses of the STPI units against the income of other taxable units. Qua disallowance of payments made to Sprint USA, the ITAT held that the payment is in the nature of royalty and subject to deduction of tax at source. The ITAT did not adjudicate the ground of appeal on the issue of miscellaneous income being granted tax holiday deduction. The ITAT allowed the revenue's appeal on the issue of interest under Section 234D of the Act. The ITAT dismissed the cross objection of the assessee.

3. As overlapping questions of law are involved in these appeals, the issues, which are common, are dealt with in tandem, considering the arguments advanced by either side on each issue.

FIRST SUBSTANTIAL QUESTION OF LAW IN T.C.A.No.277 OF 2016 AND SOLE SUBSTANTIAL QUESTION OF LAW IN T.C.A.No.280 OF 2016

4. This issue pertains to set-off of losses of the units of the assessee against the income from other units in arriving at total income. The said claim of the assessee was rejected by all the authorities.

5.1. Mr.N.V.Balaji, learned counsel for the assessee, contends that the loss of the eligible units could be set off against other income of the taxpayer, since the provisions of Section 10A/10B provide a deduction. To fortify the said submission, he placed reliance on a decision of the Supreme Court in the case of *CIT v. Yokogawa India Limited*[1].

1 *(2017) 2 SCC 1*

5.2. Learned counsel for the assessee, referring to the Circular No.7/DV/2013, dated 16.7.2013, which was also referred to in *CIT v. Yokogawa India Limited* (supra), submitted that the circular makes it abundantly clear that losses incurred by units eligible for tax holiday deduction can be set off against other taxable income/ income of units not eligible for tax holiday deduction.

5.3. It is further submitted that, in assessee's own case, a Co-ordinate Bench of this Court, vide judgment dated 20.10.2021 passed in T.C.A Nos.1234 to 1236 of 2015, following the decision of the Supreme Court in *CIT v. Yokogawa India Limited* (supra), answered the issue in favour of the assessee.

6.1. Mr.Karthik Ranganathan, learned Senior Standing Counsel appearing on behalf of the revenue, while distinguishing the applicability of the decision of the Supreme Court in *CIT v. Yokogawa India Limited* (supra), submitted that the Supreme Court did not deal with a case of loss making 10A unit against the profits

of non-10A unit, but, on the facts of the said case, held that the profits of a 10A unit have to be treated independently and all the benefits of deduction/exemption have to be first given to that unit which will be completed at Chapter IV of the Act stage itself.

6.2. It is further contended that, as per Section 10A(6) of the Act, after the amendment in 2003, all the losses that have been incurred by a 10A unit have to be carried forward until the 10 years tax holiday period is over and thereafter, it can be adjusted/offset against the profits earned by the assessee. He hastened to add that this position has also been accepted by various assessees who were parties to the decision in *CIT v. Yokogawa India Limited* (supra), as is evident from paragraph 16 of the said judgment in which carrying forward of the the losses of a 10A unit after the tax holiday period and setting off thereafter has been accepted by the assessees.

6.3. It is, thus, submitted that the losses of the various 10A units, as claimed by the assessee, cannot be adjusted against the

profits of non-10A units and the said will run afoul of the ratio laid down in *CIT v. Yokogawa India Limited* (supra)

7.1. On the issue of claim of set-off of losses of the units of the assessee against the income from other units in arriving at total income, the ITAT took into consideration its earlier order dated 23.1.2013 in the assessee's own case for the assessment years 2005-2006 and 2007-2008; and the order dated 11.3.2014 in respect of the assessee for the assessment year 2008-2009.

The earlier orders passed by the ITAT, which have been followed for the relevant assessment years in the present cases, relied upon the orders passed by the ITATs in other cases, placing reliance upon the decisions of the Karnataka High Court in *CIT and another v. Yokogawa India Ltd and others*[2]; and *CIT and another v. Tata Elxsi Ltd and others*[3], wherein it has been held that current year's profit of the eligible units should not be reduced by setting off of the brought forward losses of earlier years, even though relating to eligible units. It was also held therein that the Assessing

2 *(2012) 246 CTR 226 (Kar)*
3 *(2013) 247 CTR 334 (Kar)*

Officer has to give deduction under Section 10A of the Act on eligible profits of the current assessment year.

The ITAT has, thus, followed its earlier orders in respect of the assessee's own case for the assessment years 2005-2006, 2007-2008 and 2008-2009 and answered the issue in favour of the assessee.

7.2. The submission made by learned counsel for the Revenue that losses of 10A units cannot be adjusted against the profits of non-10A units; that the decision of the Supreme Court in *CIT v. Yokogawa India Limited* (supra) is distinguishable; and that as per Section 10A(6) of the Act, after the amendment in 2003, all the losses that have been incurred by a 10A unit have to be carried forward until the 10 years tax holiday period is over and thereafter it can be adjusted/offset against the profits earned by the assessee, is required to be tested in the light of the Supreme Court decision in the case of *CIT v. Yokogawa India Limited* (supra), on which heavy reliance is placed by learned counsel for the assessee. Not only this, the assessee has also relied upon the Circular dated

16.7.2013, which also clarifies the issue.

7.3. It is relevant to note that the claim of the assessee was allowed on the basis of the order passed by the Karnataka High Court in *CIT and another v. Yokogawa India Ltd and others* (supra). The appeal preferred by the Revenue before the Supreme Court against the said order was dismissed and the order passed by the Karnataka High Court was affirmed.

7.4. The issue that arose for consideration before the Supreme Court, as noted therein, was as below:

> *"2. The true and correct meaning and effect of the provisions of Section 10-A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") is the principal issue arising for determination of the Court. At the outset, it must be made clear that the decision of this Court with regard to the provisions of Section 10-A of the Act would equally be applicable to cases governed by the provisions of Section 10-B in view of the said later provision being pari materia with Section 10-A of the Act though governing a different situation."*

7.5. The broad question indicated above was further dissected by the Supreme Court into five specific questions as below:

> *"3.1. (i) Whether Section 10-A of the Act is beyond the purview of the computation mechanism of total income as defined under the Act? Consequently, is the income of a Section 10-A unit required to be excluded before arriving at the gross total income of the assessee?*
>
> *3.2. (ii) Whether the phrase 'total income' in Section 10-A of the Act is akin and pari materia with the said expression as appearing in Section 2(45) of the Act?*
>
> *3.3. (iii) Whether even after the amendment made with effect from 1-4-2001, Section 10-A of the Act continues to remain an exemption section and not a deduction section?*
>
> *3.4. (iv) Whether losses of other 10-A units or non 10-A units can be set off against the profits of 10-A units before deductions under Section 10-A are effected?*
>
> *3.5. (v) Whether brought forward business losses and unabsorbed depreciation of 10-A units or non 10-A units can be set off against the profits of another 10-A units of the assessee?"*

7.6. The Hon'ble Supreme Court noted the statutory scheme under Section 10A of the Act, as it existed prior to its amendment by the Finance Act, 2000 with effect from 1.4.2001, as also the effect of subsequent amendment of Section 10A of the Act by the Finance Act, 2003 with retrospective effect from 1.4.2001.

At this juncture, it is to be noted that the relevant assessment years in the present cases are subsequent to the aforesaid amendments and, therefore, the decision of the Supreme Court would be applicable on all fours.

7.7. On analyzing the provisions contained in Section 10A of the Act, their Lordships in the Supreme Court noted that the amendment of Section 10A by the Finance Act, 2000 with effect from 1.4.2001 specifically uses the words "*deduction of profits and gains derived by an eligible unit ... from the total income of the assessee*". They further noted that, after amendment, though Section 10A of the Act had changed its colour from being an exemption section to a provision providing for deduction, yet it continued to remain in Chapter III of the Act, which deals with

incomes which do not form part of the total income.

7.8. Their Lordships also referred to Circular No.7, dated 16.7.2013 as also another Circular No.1 of 2013, dated 17.1.2013 and noted certain discrepancies.

7.9. After referring to the provisions contained in Section 10A of the Act, as it stood prior to amendment and after amendment, as also various circulars, the Hon'ble Supreme Court held as below:

> *"14. ... The true and correct purport and effect of the amended section will have to be construed from the language used and not merely from the fact that it has been retained in Chapter III. The introduction of the word 'deduction' in Section 10-A by the amendment, in the absence of any contrary material, and in view of the scope of the deductions contemplated by Section 10-A as already discussed, it has to be understood that the section embodies a clear enunciation of the legislative decision to alter its nature from one providing for exemption to one providing for deductions.*
>
> *15. The difference between the two expressions 'exemption' and 'deduction', though broadly may appear to be the same i.e. immunity from taxation, the practical*

effect of it in the light of the specific provisions contained in different parts of the Act would be wholly different. The above implications cannot be more obvious than from the case of Civil Appeals Nos. 8563 and 8564 of 2013 and civil appeal arising out of SLP (C) No. 18157 of 2015, which have been filed by loss-making eligible units and/or by non-eligible assessees seeking the benefit of adjustment of losses against profits made by eligible units."

7.10. What has been observed by the Hon'ble Supreme Court in paragraph 15, extracted herein above, makes it clear that the cases also involved loss making eligible units and/or non-eligible assessees seeking the benefit of adjustment of losses against profits made by eligible units.

7.11. In the said decision, it was further observed as under:

"16. ... The provisions of Sections 80-HHC and 80-HHE of the Act providing for somewhat similar deductions would be wholly irrelevant and redundant if deductions under Section 10-A were to be made at the stage of operation of Chapter VI of the Act. The retention of the said provisions of the Act i.e. Sections 80-HHC and 80-HHE, despite the amendment of Section 10-A, in our view,

indicates that some additional benefits to eligible Section 10-A units, not contemplated by Sections 80-HHC and 80-HHE, was intended by the legislature. Such a benefit can only be understood by a legislative mandate to understand that the stages for working out the deductions under Sections 10-A and 80-HHC and 80-HHE are substantially different."

7.12. The interpretation placed on the scheme of provision contained in Section 10A of the Act was further clarified as below:

"17. From a reading of the relevant provisions of Section 10-A it is more than clear to us that the deductions contemplated therein are qua the eligible undertaking of an assessee standing on its own and without reference to the other eligible or non-eligible units or undertakings of the assessee. The benefit of deduction is given by the Act to the individual undertaking and resultantly flows to the assessee. This is also more than clear from the contemporaneous Circular No. 794 dated 9-8-2000 which states in para 15.6 that,

'The export turnover and the total turnover for the purposes of Sections 10-A and 10-B shall be of the undertaking located in specified zones or 100% export-oriented undertakings, as the case may be, and this shall not have any material relationship with the other business of the

assessee outside these zones or units for the purposes of this provision'.

18. If the specific provisions of the Act provide [first proviso to Sections 10-A(1); 10-A(1-A) and 10-A(4)] that the unit that is contemplated for grant of benefit of deduction is the eligible undertaking and that is also how the contemporaneous circular of the department (No. 794 dated 9-8-2000) understood the situation, it is only logical and natural that the stage of deduction of the profits and gains of the business of an eligible undertaking has to be made independently and, therefore, immediately after the stage of determination of its profits and gains. At that stage the aggregate of the incomes under other heads and the provisions for set off and carry forward contained in Sections 70, 72 and 74 of the Act would be premature for application. The deductions under Section 10-A therefore would be prior to the commencement of the exercise to be undertaken under Chapter VI of the Act for arriving at the total income of the assessee from the gross total income. The somewhat discordant use of the expression 'total income of the assessee' in Section 10-A has already been dealt with earlier and in the overall scenario unfolded by the provisions of Section 10-A the aforesaid discord can be reconciled by understanding the expression 'total income of the assessee' in Section 10-A as 'total income of the undertaking'."

7.13. The aforesaid decision of the Hon'ble Supreme Court is clearly applicable to the facts of the present case and the loss of the eligible units could be set-off against the other income of the tax payer in view of the provision relating to deduction as contained in Section 10A of the Act and it cannot be said that the decision of the Supreme Court does not apply in a case of loss-making 10A unit against the profits of non-10A unit.

7.14. The Circular dated 16.7.2013, which was considered by the Supreme Court in the aforesaid decision and also placed for our perusal, clearly provides as below:

> *"5.2 The income computed under various heads of income in accordance with the provisions of Chapter IV of the IT Act shall be aggregated in accordance with the provisions of Chapter VI of the IT Act, 1961. This means that first the income/loss from various sources i.e. eligible and ineligible units, under the same head are aggregated in accordance with the provisions of section 70 of the Act. Thereafter, the income from one ahead is aggregated with the income or loss of the other head in accordance with*

the provisions of section 71 of the Act. If after giving effect to the provisions of sections 70 and 71 of the Act there is any income (where there is no brought forward loss to be set off in accordance with the provisions of section 72 of the Act) and the same is eligible for deduction in accordance with the provisions of Chapter VI-A or sections 10A, 10B etc. of the Act, the same shall be allowed in computing the total income of the assessee."

7.15. In respect of the previous assessment years, in assessee's own case, referred to herein above, the ITAT decided the issue in favour of the assessee and learned counsel for the Revenue could not satisfy the court that the aforesaid orders were taken to higher courts and reversed.

8. In conclusion, the first substantial question of law in T.C.A.No.277 of 2016 and the sole substantial question of law in T.C.A.No.280 of 2016 is decided in favour of the assessee and against the revenue.

SECOND & THIRD SUBSTANTIAL QUESTIONS OF LAW IN TCA No.277 OF 2016 AND FIRST & SECOND SUBSTANTIAL QUESTIONS OF LAW IN TCA No.278 of 2016

9. These issues challenge the finding rendered by the ITAT that the amount paid by the assessee to Sprint USA, for International Private Leased Circuits (IPLC), is to be disallowed under section 40(a)(i) of the Act, and the said amount constitutes 'Royalty' under Section 9 of the Act read with the Double Taxation Avoidance Agreement (DTAA) between India and United States of America.

10.1. Learned counsel for the assessee submitted that, for assessment years 2002-2003 and 2003-2004, though an order was passed under Section 201 of the Act holding the assessee liable to deduct tax at source on payments made to Sprint USA, on appeal, the CIT(A) held in favour of the assessee. In the appeal preferred by the Revenue against the order passed by the CIT(A) in the proceedings under Section 201 of the Act, the ITAT, following the decision in *Verizon Communications Singapore PTE Ltd v. ITO*[4], allowed the appeal of the Revenue.

However, for the assessment year 2003-2004, the Assessing

4 *(2013) 39 taxmann.com 70 (Madras)*

Officer, vide his order under Section 143(3) of the Act, disallowed the deduction towards payment to Sprint USA applying Section 40(a)(i) of the Act, which was confirmed by the CIT(A) and the ITAT. The ITAT, in arriving at such conclusion, followed its earlier order, referred to in the preceding paragraph, and passed the orders impugned in TCA Nos.277 and 278 of 2016. It is submitted that ITAT, solely based on decision in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), jumped to the conclusion that the appellant's case is akin to case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra), without independently analyzing any material pertaining to the claim of the assessee in this regard.

10.2. It is further submitted that the facts of the present case and that of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) are poles apart, as none of the services of Sprint USA is rendered in India and they were rendering services pertaining to data transmission outside India. He added that when services are not rendered in India, there can be no tax incidence for the assessment years in question.

10.3. It is also submitted that the decision of this court in

Verizon Communications Singapore PTE Ltd v. ITO (supra) is no more good law in view of the judgment of the Supreme Court in *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT*[5], wherein, while considering the effect of amendment to the Act without making any change in the DTAA, it was held that the amendment to the Act does not alter the DTAA. He further contended that in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), it was observed that "Royalty" under the Act and the DTAA between India and Singapore are identical in scope, which runs counter to the decision of the Supreme Court in *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra).

10.4. Learned counsel for the assessee argued that the Delhi High Court in *DIT v. New Skies Satellite BV*[6], held that payment for transponder leaser is only a payment towards service and, therefore, would not fall within the ambit of royalty, particularly when the payer did not have control or possession of the transponder. He added that the Supreme Court in *Engineering*

5 *(2021) 432 ITR 471 (SC)*
6 *(2016) 68 Taxmann.com 9 (Del) : (2016) 285 CTR 1 (Del)*

Analysis Centre of Excellence Pvt. Ltd v. CIT (supra), held that the view expressed in *DIT v. New Skies Satellite BV* (supra) is correct. He submits that, in effect, the decision of this court in *Verizon Communications Singapore PTE Ltd v. ITO* (supra) is overruled by the Supreme Court.

10.5. It is argued by learned counsel for the assessee that, in sooth, the unilateral amendment to the Act cannot be construed to be a modification of the DTAA entered into between India and USA. He submitted that in the case of *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra), the Supreme Court has emphatically held that persons who pay TDS and/or assessees in the nations governed by a DTAA have a right to know exactly where they stand in respect of the treaty provisions that govern them and for this reliance can be placed upon the Organisation for Economic Co-operation and Development (OECD) Commentary for provisions of the OECD Model Tax Convention, which are used without any substantial change by bilateral DTAAs.

10.6. It is contended that *de hors* the meaning of "Royalty" in respect of clause (iva) to Explanation 2 to Section 9(1)(vi) of the Act, the meaning in respect of Royalty under DTAA will have to be interpreted on the strength of OECD commentary, as per which the meaning of "Royalty" under the DTAA will be only in respect of use of equipment, where the possession/control is with the payer.

10.7. He relied upon yet another decision of the Delhi High Court in *CIT v. Telstra Singapore Pte Ltd*[7], to bolster his argument that payments towards IPLC shall not amount to royalty.

11.1. Learned Standing Counsel for the revenue, refuting the aforesaid submissions, contended that the assessee had made certain payments to Sprint USA for using the undersea cables for the purpose of its business and such undersea cables can be treated as equipment and, therefore, the payments made for using the equipment would squarely fall within the definition of "royalty" as defined in Clause (iva) to Explanation 2 to Section 9(1)(vi) of the Act. To boot, he submitted that the definition of royalty under the

7 *(2024) 165 taxmann.com 85 (Del)*

India-USA Tax Treaty (DTAA) also is similar to what is found in the Act and, therefore, even under the tax treaty the payments made by the assessee would fall within the definition of royalty, as the treaty does not have any restricted meaning to the term "royalty".

11.2. It is also submitted that the case of the assessee is squarely covered by the decision of this court in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), wherein it was held that the payments made by an Indian company to a foreign company for using its IPLC would squarely fall within the definition of royalty, both under the Act and the tax treaty between India and Singapore (in that case). Further, this Court had relied on Clause (iva) to Explanation 2 to Section 9(1)(vi) of the Act which states that "any payment made for the use or right to use any industrial, commercial or scientific equipment" will be treated as royalty. The said decision holds the field, in as much as no stay was granted, nor it was overruled by the Supreme Court.

11.3. It is further submitted that the decision in *Engineering*

Analysis Centre of Excellence Pvt. Ltd v. CIT (supra) is not directly on the issue involved in this case, but was qua copyright of computer software and payments made for use of a copyright cannot be compared with the definition for use of equipment. He submitted that, forsooth, the said decision is not applicable to the case on hand.

11.4. Nextly, it is submitted that in the *Poompuhar Shipping Corporation Limited v. ITO*[8], it has been held that mere use of an equipment (ship) would amount to royalty. By the same token, the use of the IPLC, which is an undersea cable, should be treated as a payment for use of an equipment and, therefore, would fall within the definition of royalty.

11.5. Learned Standing Counsel relied on a decision of the Delhi High Court in the case of *HCL Ltd v CIT*[9], wherein it was held that payments can be of two types. One, may be either for 'use' or 'right to use' of an equipment or an intellectual property right (as it

8 *(2013) 38 taxmann.com 150 (Madras)*
9 *(2015) 54 taxmann.com 231 (Delhi)*

was in that case) or the payment may be for the 'transfer of right to use' or 'sale' of the same equipment or intellectual property right. The Court held that insofar as the latter two payments are concerned, they will not attract any royalty, because they may at best be treated as capital gains or business income, if there is a permanent establishment in the country from which the payments are made. On the other hand, the payments made for the former two situations i.e., use or right to use of an equipment or an intellectual property, it was held that they will be treated as a royalty and, therefore, would attract withholding tax as per the Act or the tax treaty whichever is more beneficial to the taxpayers. In the light of the said decision, he submits that mere use is sufficient to attract royalty payment and there is no necessity that the control and/or possession of such equipment should also be with the assessee to be treated as royalty, because if the possession and control are also handed over to the assessee without there being an actual sale, then it would amount to "transfer of right to use" of an equipment, which is treated as a "deemed sale", which is just one step short of actual sale. Even though possession and control were

not granted to the assessee in the case on hand, given the locus of the equipments (they were undersea cables), it is only natural to arrive at a conclusion that the payments made will fall within the meaning of use or a right to use of the equipments, since the assessee cannot have possession over the same, but is benefited from those equipments which belong to Sprint USA.

11.6. He submitted that reliance placed by the appellant on the tax treaties of other countries and the OECD model tax treaty is off the beam. It is argued that no reliance can be placed on another tax treaty, which, according to the assessee, is more beneficial, unless there is a Most Favoured Nation (MFN) clause in the India-USA tax treaty, which alone permits the reliance on other tax treaties (third country tax treaties) that have more beneficial clauses to the assessee. Further, the reliance on the OECD model tax treaty is over the fence, as, admittedly, India is not even a member of the OECD. Since India and USA are members of UN, he submitted that reliance should be placed on the UN model tax treaty, which gives a wider meaning to the word "use of and right to

use of" which does not require any possession or control requirement to fall within the definition of royalty.

12.1. The facts which are not in dispute are that the assessee has made payments to a foreign based company, namely, Sprint USA, for availing services of international private leased circuits, as it is engaged in the business of software development and export, and is also rendering related services.

12.2. The assessee claimed deduction under Section 40(a)(i) of the Act. The Assessing Officer found that the assessee was not entitled to any such deduction claimed by it and concluded that the amounts paid by the assessee to Sprint USA was without making deduction of tax at source. In the appeal before the CIT(A), the assessee challenged the order in so far as the assessee's claim with regard to payments made to Sprint USA were concerned. On this issue of disallowance of payments made to Sprint USA, the appeal was dismissed. The ITAT also dismissed the claim on the issue of disallowance of payments made to Sprint USA, following the

judgment of this Court in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) and held that the payment is in the nature of royalty and, therefore, subject to deduction of tax at source.

12.3. The seminal issue requiring consideration is whether the payment made by the assessee to Sprint USA constitutes royalty as provided under Section 9 of the Act read with the DTAA between India and United States of America.

12.4. In order to decide the issue, it is necessary to first set out the relevant provisions of the Act.

12.4.1. Section 5 of the Act provides for scope of total income as below:

> *"5. Scope of total income.—*
> *(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—*
> *(a) is received or is deemed to be received in India in such year by or on behalf of such*

person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) accrues or arises to him outside India during such year:

Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total

income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

12.4.2. Section 9 of the Act makes a provision as to when income is deemed to accrue or arise in India. The relevant provision with reference to which the issue has been considered by the ITAT, CIT(A) and the Assessing Officer is reproduced as below:

"9. Income deemed to accrue or arise in India.—

(1) The following incomes shall be deemed to accrue or arise in India:—

...

(vi) income by way of royalty payable by—

(a) the Government; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession

carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government:

Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.

...

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which

would be the income of the recipient chargeable under the head "Capital gains") for—

...

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB.

...

Explanation 3.—For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used

directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret."

12.4.3. As the issue involved in the case is whether the assessee is entitled to claim deduction under Section 40(a)(i) of the Act, in respect of payment made to foreign based company, and the liability is to be ascertained by taking into consideration not only the provisions contained in Section 9 of the Act, but also the provisions contained in DTAA as between India and USA, Section 90 of the Act is also relevant, which provides as below:

"90. Agreement with foreign countries or specified territories.—

(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified

territory, as the case may be,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee."

12.5.1. Taking into consideration the provisions of Section 9 of the Act, including the amendments made therein by introducing and adding Explanations 4, 5 and 6, in respect of almost a similar transaction, the Division Bench of this Court in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) held that such payments made would constitute royalty within the meaning of that expression as defined under Section 9 of the Act, with the result that it would stand excluded for the purposes of claiming deduction as provided under Section 40(a)(i) of the Act and, consequently,

includable as an income and liable for deduction of tax at source.

12.5.2. The aforesaid decision has been made a basis to disallow the claim of the assessee by holding that what has been paid by the assessee to Sprint USA constitutes royalty.

12.5.3. The factual premise and the issue which arose for consideration in the said case, and as set out in the order, are that the assessee company therein, namely Verizon Communications Singapore PTE Ltd, originally called as MCI Worldcom Asia Pte Ltd, and part of the global telecommunication conglomerate of MCI, USA, was a non-resident company engaged in the business of providing international connectivity services. Being a point-to-point private line used by an organisation to communicate between offices that are geographically dispersed throughout the world, the assessee therein provided a private link that would transport voice data and video traffic between the offices in different countries. Thus, IPLC is an end-to-end managed dedicated bandwidth service that provided internet service to customers for various applications.

The international leg of the telecom services provided outside India was provided by the assessee therein. Since in India, under the Indian Telecom Regulations, only the licensed service provider could provide international long distance communication services on the Indian leg, and the assessee therein was not a licensed service provider under the Indian laws, Videsh Sanchar Nigam Ltd (VSNL), a public sector undertaking, provided the Indian leg of the international service to the customers. Thus, a customer interested in taking a lease connection between its office in India and an overseas location entered into an arrangement with the assessee for the provision of international connectivity in the overseas leg and with VSNL for Indian half of the connectivity. VSNL transmitted the traffic of the customer in India from the customer's office in India and transmitted the traffic to a virtual point outside India and the assessee transmitted it up to the customer location outside India. It was stated that the assessee uses its telecom service equipment situated outside India in providing the international half circuit. It was also stated that the gateway/the landing station in India used in transmitting the traffic within India belonged to VSNL

and is used by VSNL for providing Indian end services pursuant to its contract with the customer. In the said case, on the analysis of the facts, the Assessing Officer came to the conclusion that the payment received by the assessee therein in providing IPLC was taxable as "royalty" for use of or right to use of commercial and scientific equipment under Section 9(1)(vi) read with Explanation 2 to the Act and the relevant provisions of the DTAA between India and Singapore.

12.5.4. In *Verizon Communications Singapore PTE Ltd v. ITO* (supra), the assessee objected to the assessment on the basis that the payments were made in the nature of 'royalty' taxable under Section 9(1)(vi) read with Explanation 2(iva) and (vi) of the Act primarily on the ground that the revenue earned by the assessee could not be considered as 'royalty' paid for the use of the equipment under the Act. It was the case of the assessee that the customers have no knowledge of the equipment/network used by the assessee for the provision of the service. It was also pleaded that the the customers do not have the control with reference to the

usage of the equipment/network used for rendering the service. The case of the assessee was that no part of the international network is exclusive for any Indian customer or customers as a whole and that the agreement between the assessee and the customers being one for rendering of service by the assessee, the payment could not be treated as 'royalty'. The view taken by the Assessing Officer, CIT(A) and the ITAT in that case is as under:

> *"... the receipt of consideration for rendering of services to the end user is workable only when the assessee and the VSNL are considered to be rendering the service jointly to the end user in India. The agreements between the assessee and the end user and the VSNL are part of one transaction, but executed through several agreements/arrangements. The payments made by the customers for the offshore services rendered by the non-resident assessee are part of one single agreement to provide IPLC and, hence, the receipts are taxable as 'royalty' under section 9(1)(vi) read with Explanation 2 to the Income-tax Act. ... Thus, payments received for providing communication bandwidth in the form of IPLC to customers came to be treated as 'royalty'. The transmission cables and hightech instruments providing a seamless circuit are 'equipment' and the income earned by permitting the use of or right to use of equipment fell within the meaning of 'royalty', both under the Income-*

tax Act and under the DTAA between India and Singapore."

12.5.5. In the aforesaid case, the ITAT further that, as per the agreement, the customer acquired significant, economic or possessory interest in the equipment of the assessee to the extent of the bandwidth hired by the customer. This was made available to the assessee on a dedicated basis. The agreement with VSNL for split billing is only to overcome the telecom regulatory regime prevailing in India. VSNL was a sub-contractor and a provisioning entity on behalf of the assessee and the IPLC is a hightech circuit comprising transmission cables and sophisticated equipment. Therefore, even if the payments are not treated as not relating to the use of the 'equipment', they should be considered as payment for the use of the 'process'.

12.5.6. The submission made on behalf of the revenue before this court in that case was that the character of the receipt clearly fits in with Section 9(1)(vi) read with Explanation 2(iva) of the Act for equipment royalty and, alternatively, it can also be taxed as

process, falling under Explanation 2(iii) to Section 9(1)(vi) of the Act that receipt would nevertheless be held as 'royalty'. It was also submitted that for royalty there need not be a physical or right to use to the user and so long as there is nexus between the user, the situs of the usage (in India) and the purpose of the use (for offering seamless internet facility), economic exploitation of the equipment gives rise to the income to be taxed as 'royalty'.

12.5.7. Importantly, the revenue, in the said case, also referred to 2012 amendment adding Explanation 5, to submit that Explanation 5 clearly pointed out that for treating a receipt as 'royalty', even possession or control need not be proved. The submission advanced was that VSNL's services taken by the assessee was only part of the agreement that the assessee had with the customer and VSNL acted as provisioning agent. As the network offered is a single continuous unified system, it cannot be bisected as onshore and offshore parts and, thus, when the assessee offered seamless connectivity from one end to the other, the same is separate logically and artificially because of the geographical

factors. Therefore, the entire equipment provided for seamless connection are one whole indivisible equipment towards exploitation of the connectivity offered to the end. Thus, the payment is not for pro rata basis, but towards the entire service offered.

12.5.8. Further submissions made on behalf of the revenue were with specific reference to Explanation 6 to Section 9(1)(vi) of the Act to buttress the revenue's stand that the payment is also qua the process as falling under Explanation 2(iii) to Section 9(1)(vi) of the Act, and that cable is also treated as a commercial equipment and, thus, for the equipment usage and the services utilised, the payment falls within the meaning of 'royalty' and Clause (iva) of Explanation 2 to Section 9(1)(vi) of the Act includes licence and lease.

12.5.9. Relying upon various judgments, it was submitted on behalf of the revenue that a right to access and exploit a part of segment of a larger system to use the capacity of the system and the consideration paid therefor clearly falls under Clause (iva) of

Explanation 2 to Section 9(1)(vi) of the Act and, hence, 'royalty'. It was also submitted therein that it is a right to use a process and a right to use equipment coming within Explanation 2 to Section 9(1)(vi) of the Act.

12.5.10. The revenue relied on the provisions contained in Section 9(1)(vi) of the Act and Explanation 2(iva) thereof, besides Explanations 5 and 6 added by way of amendment of 2012, to submit that the control and possession of the equipment is not necessary to constitute payment as 'royalty' and that the Explanation included the right to use a process.

12.5.11. Another distinctive feature noted by this court in the said case was that the equipment is transferred to VSNL by MCI for a token payment of Rs.10,000, and the ownership remained only with MCI, because VSNL does not have the right to sell the equipment and the equipment is to be handed over at any time to MCI on demand for payment of Rs.10,000. The payment by VSNL was only a token payment and, hence, not the actual consideration

for the equipment. Taking into consideration the aforesaid aspect, it was held that the appellant therein had to take the services of VSNL, as the provisioning entity, for providing that part of the services in India having regard to the Regulations of the Telecom Regulatory Authority of India, and as the assessee did not possess the appropriate licence for doing so in India, it had taken the services of VSNL as provisioning entity.

12.5.12. The terms of DTAA as between India and Singapore were also taken into consideration in *Verizon Communications Singapore PTE Ltd v. ITO* (supra) and upon reading thereof, it was concluded that the definition of 'royalty' under DTAA and the Act are pari materia. Reference was also made to Explanation 6 to Section 9(1)(vi) of the Act, which defines 'process' to mean and include transmission by satellite (including uplinking, amplification, conversion for down-linking of any signal) cable, optic fibre, or by any other similar technology, whether or not such process is secret.

12.5.13. Taking into consideration that the payment for the

bandwith amounts to 'royalty' for the use of the process, the payment received by the assessee therein, which was treated as 'royalty' by the ITAT, was upheld by this Court in the aforesaid decision and it was concluded thus:

> *"102. In the circumstances, we reject the case of the assessee holding that the receipts are liable to be treated as 'royalty' for the use of IPLC under section 9(1)(vi) read with Explanation 2(iva) and correspondingly article 12(3) of the DTAA between India and Singapore. We also agree with the Tribunal that even if the payment is not treated as one for the use of the equipment, the use of the process was provided by the assessee, whereby through the assured bandwidth the customer is guaranteed the transmission of the data and voice. The fact that the bandwidth is shared with others, however, has to be seen in the light of the technology governing the operation of the process and this by itself does not take the assessee out of the scope of royalty. Thus, the consideration being for the use and the right to use of the process, it is 'royalty' within the meaning of clause (iii) of Explanation 2 to section 9(1)(vi) of the Income-tax Act."*

12.5.14. The decision of the Delhi High Court in the case of *Asia Satellite Telecommunications Private Limited v. DIT*[10], was also

10 *(2011) 332 ITR 340 (Delhi)*

sought to be relied upon by the assessee in *Verizon Communications Singapore PTE Ltd v. ITO* (supra) in support of its contention that the agreement between the assessee and customer contemplated rendering of services only and, hence, consideration paid would not partake the character of royalty. Why this court did not agree with the view taken by the Delhi High Court in *Asia Satellite Telecommunications Private Limited v. DIT* (supra) shall be dealt with little later.

12.5.15.1. In the case of *Asia Satellite Telecommunications Private Limited v. DIT* (supra), it was held that receipts earned from providing data transmission services, through the lease of transponder capacity of its satellites, do not constitute 'royalty' within the meaning of Section 9(1)(vi) of the Act. The view taken was that, while providing transmission services to customers, the control of the satellite always remained with the assessee therein and the customers are only given access to the broadband available with the transponder. The customer, therefore, does not use satellite or the process involved in its operations. That being so,

the payment cannot be termed as 'royalty' for the use of a process or equipment. The court recognized therein that definition of 'royalty' in the section is with respect to permission granted to use the right in respect of the patent, invention, process, etc., all essentially form part of intellectual property. This permission restricts itself to merely letting an asset. The permission does not go so far to allow alienation of the asset itself. Therefore, it is not so restricted as to qualify as a case where the licensor uses the asset himself, albeit for the purposes of his customers.

12.5.15.2. In *Asia Satellite Telecommunications Private Limited v. DIT* (supra), the Delhi High Court took note of the features of the agreement entered by the assessee in that case, which was a foreign company incorporated in Hong Kong, and its customers, which were television channels. The agreement was essentially one of allocation of transponder capacity available on the satellite to enable the channels to relay their signals. The customer had their own relaying facilities. Further, the transponder receives the signals, amplifies it and downlinks it to facilitate the

transmission of signals. Quoting the judgment of the Authority for Advance Rulings in *ISRO*[11], the court held that it becomes clear that all that the customer gets through the agreement with the assessee is mere access to broadband width available in the transponder. The control over the parts of the satellites and, naturally, the transponder remains with the assessee. At no point does the assessee cede control over the satellite. Logically, since the transponder is a part of the satellite that cannot be severed from it, the process carried on in the transponder in receiving signals and retransmitting the same, is an inseparable part of the process of the satellite and that process is utilized only by the assessee who is in control. It was noted that the Authority for Advance Rulings had specifically rejected the contention of the revenue that, in substance, there is use of transponder by the assessee. The fact that the transponder automatically responds to the data commands sent from the ground station network and retransmits the same data over a wider footprint area does not mean that the control and operation of the transponder is with the customer.

11*(2008) 307 ITR 59 (AAR)*

12.5.15.3. Therefore, what was held in *Asia Satellite Telecommunications Private Limited v. DIT* (supra) was that the presence of control was a critical factor in adjudging whether there was use of a particular process. However, in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), this court did not agree with the assessee regarding the applicability of the decision in *Asia Satellite Telecommunications Private Limited v. DIT* (supra), for the reason that the decision of the Delhi High Court in that case and the ruling of the Authority for Advance Rulings in *ISRO* (supra) were rendered prior to insertion of Explanation 5 and that the decision of the Delhi High Court rested on the facts therein. The observations made in *Verizon Communications Singapore PTE Ltd v. ITO* (supra) in this regard are quoted below:

> *"87. We do not agree with the assessee principally for the reason that the decision of the Delhi High Court reported in Asia Satellite Telecommunications Co. Ltd. v. DIT (2011) 332 ITR 340 (Delhi) and the rulings of the Authority for Advance Rulings reported in (2008) 305 ITR 37 (AAR) (Dell International Services (India) Pvt. Ltd., In re and Cable and Wireless Network India P. Ltd., In re (2009) 315 ITR 72 (AAR) on which heavy reliance was made were all rendered prior to the insertion of*

Explanation 5 and that the decision of the Delhi High Court rested on the facts therein. The amendments by insertion of Explanation 5 gives a very expansive meaning to the term "royalty" and this has a bearing on the issue so too the various clauses in the agreements which are to be looked at in a holistic manner. The agreement entered into between the assessee and the customer herein is for providing of seamless point-to-point private line so as to enable the customer to communicate between its office that are geographically dispersed. The service order reveals that the parties had agreed for a particular bandwidth and in entering this the assessee had provided the necessary equipment at customer premises, configured and customised to ensure that the customer gets the uninterrupted connectivity from one end to the other end in different geographical point."

12.5.15.4. It is, thus, clear that one of the main reasons for not agreeing with the view taken in *Asia Satellite Telecommunications Private Limited v. DIT* (supra), was that the said judgment was rendered prior to amendment brought in vide Finance Act, 2012. On facts, in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), it was found that the agreement entered into between the assessee and customer was for providing seamless

point-to-point private line so as to enable the customer to communicate between its offices that are geographically dispersed and further that the service order reveals that the parties had agreed for a particular bandwidth and, in entering this, the assessee had provided the necessary equipment at customer premises, configured and customised to ensure that the customer gets the uninterrupted connectivity from one end to the other end in different geographical point.

12.5.16. At this stage, it is pertinent to note that the decisions of the Authority for Advance Ruling, New Delhi, in the cases of *Dell International Services India (P) Ltd, in re*[12] and *Cable and Wireless Networks India (P) Ltd, in re*[13], on which reliance was placed by the assessee therein, were held to be not applicable by this Court in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), considering the amendment brought in under the Finance Act, 2012, by the insertion of Explanations 5 and 6.

12 (2009) 308 ITR 37 (AAR – New Delhi)
13 (2009) 315 ITR 72 (AAR – New Delhi)

12.5.17. It is, thus, discernible from a close reading of the decision in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), that the said decision turned on its own distinguishing facts and on separate agreements – the agreement between the assessee and VSNL, VSNL acting as provisioning entity on behalf of the assessee, with specific reference to Explanations 5 and 6 to Section 9(1)(vi) of the Act, added by the Finance Act, 2012.

12.5.18. Moreover, the aforesaid decision was based on the conclusion that definition of 'royalty' under DTAA and the Act are *pari materia*.

12.6.1. We shall now refer to the decision of the Delhi High Court in the case of *DIT v. New Skies Satellite BV* (supra), which was upheld by the Supreme Court in the case of *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra), to find answer to the question as to whether the decision of the Supreme Court impliedly overrules the view taken in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), mainly on the ground that the

newly added Explanations vide amendment through the Finance Act, 2012 could be made applicable to the case on hand, as it relates to assessment years relevant to financial years prior to such amendment in 2012. The assessee, in the present case, has heavily relied upon the decision of the Delhi High Court in *DIT v. New Skies Satellite BV* (supra) and the Supreme Court decision in the case of *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra).

12.6.2. The factual foundation in the case of *DIT v. New Skies Satellite BV* (supra), as noted by the court therein, was that the assessee, a company incorporated in Netherlands, engages in providing digital broadcasting services. On filing a return of nil taxable income for the relevant years, the Assessing Officer again under Section 143(3) read with Section 144C of the Act, applied Section 9(1)(vi) of the Act to tax the income of the assessee as royalty. The assessee derived income from the lease of transponders of satellite. The lease was for the purpose of relaying signals of their customers - both resident and non-resident

television channels, that wish to broadcast their programmes for a particular audience situated in a particular part of the world. In that case, the assessee was chosen for the simple reason that the footprint of its satellite, i.e. the area over which the satellite can transmit its signal, includes India. The process by which the television programmes reach the viewers in India was that the television channels produced or acquired the tapes of the programmess, which they then uplink to the satellite. The satellite then receives the contents, amplifies it, changes its frequency by undertaking certain processes, and then downlinks it, scattering the signal over the area of its footprint. The cable operators who ultimately relay it to the viewers in their homes then receive the downlinked signal.

12.6.3. Though the Assessing Officer in that case held the receipts as taxable under Section 9(1)(vi) of the Act, it being royalty both under the Act as well as Indo-Netherlands DTAA, the ITAT set aside the assessment order mainly based on the decision in *Asia Satellite Telecommunications Private Limited v. DIT* (supra).

12.6.4. Assailing the correctness and validity of the order passed by the ITAT, the Revenue's case before the court was that with the insertion of the three Explanations to Section 9(1)(vi) of the Act, the matter has been settled beyond controversy and reliance could no longer be based on the decision the case of *Asia Satellite Telecommunications Private Limited v. DIT* (supra), because the basis of that ruling has been undone by insertion of Explanations 4, 5 and 6 to Section 9(1)(vi) of the Act vide Finance Act, 2012. It was argued that the amendment applied to all transactions past and present, as it imperatively suggests that if there were any doubts as to whether the activity was taxable, the same stand removed.

12.6.5. As far as the application of DTAA and whether it resulted in rendering the activity non-taxable was concerned, in it was the contention in *DIT v. New Skies Satellite BV* (supra) that the DTAA predated the amendment. Therefore, reliance placed on the decision in *Asia Satellite Telecommunications Private Limited v. DIT*

(supra), which was in relation to Section 9 of the Act, could not be said to be an authority on treaty interpretation. It was also submitted that the terms of the treaty and the terms of the pre-amended Act being similar, the subsequent amendment rendered the reasoning in *Asia Satellite Telecommunications Private Limited v. DIT* (supra) academic and, therefore, the assessee could not take shelter under the DTAA, which was cast in identical terms with the pre-amended statute, and since the same has subsequently been amended, the courts are bound to give effect to it.

12.6.6. In that case, the assessee's reply was that any change in the substantive law would not automatically result in a like change in respect of taxability of a transaction or service, which is otherwise tax exempt in terms of the DTAA or which is subject to a lower rate of taxation mandated by a treaty.

12.6.7. As to what is the effect of the clarificatory amendment inserting Explanations 4, 5 and 6 to Section 9(1)(vi) of the Act vide Finance Act, 2012, after long drawn analysis and interpretation of

the provisions contained in Section 9(1)(vi) of the Act, particularly the newly inserted Explanations 4, 5 and 6, and various decisions, no definite conclusion was arrived at, though the broad prima facie view taken was against attaching retrospective effect, with the following observations:

> *"33. There is a general presumption against retrospectivity of an amendment. This is the principle of lex prospicit non respicit which implies that unless explicitly stated, a piece of legislation is presumed not to be intended to have retrospective operation.*
>
> *...*
>
> *36. A clarificatory amendment presumes the existence of a provision the language of which is obscure, ambiguous, may have made an obvious omission, or is capable of more than one meaning. In such case, a subsequent provision dealing with the same subject may throw light upon it. Yet, it is not every time that the Legislature characterises an amendment as retrospective that the court will give such effect to it. This is not in derogation of the express words of the law in question, (which as a matter of course must be the first to be given effect to), but because the law which was intended to be given retrospective effect to as a clarificatory amendment, is in its true nature one that expands the scope of the section it seeks to clarify, and resultantly introduces new principles, upon which liabilities might arise. Such*

amendments though framed as clarificatory, are in fact transformative substantive amendments, and incapable of being given retrospective effect. ... If the amendment changes the law it is not presumed to be retrospective irrespective of the fact that the phrase used is "it is declared" or "for the removal of doubts". In determining, therefore, the nature of the Act, regard must be had to the substance rather than to form. While adjudging whether an amendment was clarificatory or substantive in nature, and whether it will have retrospective effect or not, it was held in CIT v. Gold Coin Health Food (P.) Ltd. (2008) 304 ITR 308 (SC) and CIT v. Podar Cement (P.) Ltd. [1997] 226 ITR625 (SC) that, (i) the circumstances under which the amendment was brought in existence, (ii) the consequences of the amendment, and (iii) the scheme of the statute prior and subsequent to the amendment will have to be taken note of.

37. An important question, which arises in this context, is whether a "clarificatory" amendment remains true to its nature when it purports to annul, or has the undeniable effect of annulling, an interpretation given by the courts to the term sought to be clarified. In other words, does the rule against clarificatory amendments laying down new principles of law extend to situations where law had been judicially interpreted and the Legislature seeks to overcome it by declaring that the law in question was never meant to have the import given to it by the court?

38. The circumstances in this case could very well go to show that the amendment was no more than an exercise in undoing an interpretation of the court which removed income from data transmission services from taxability under section 9(1)(vi). It would also be difficult, if not impossible to argue, that inclusion of a certain specific category of services or payments within the ambit of a definition alludes not to an attempt to illuminate or clarify a perceived ambiguity or obscurity as to interpretation of the definition itself, but towards enlarging its scope. Predicated upon this, the retrospectivity of the amendment could well be a contentious issue. Be that as it may, this court is disinclined to conclusively determine or record a finding as to whether the amendment to section 9(1)(vi) is indeed merely clarificatory as the Revenue suggests it is, or prospective, given what its nature may truly be."

12.6.8. However, in the said case, as the court was of the view that the issue of taxability could be resolved without taking a final view on the issue of retrospectivity, it proceeded to decide the issue of taxability by examining and interpreting the provisions of the Act and applicable DTAA.

12.6.9. It is extremely relevant to mention herein that in *DIT v. New Skies Satellite BV* (supra), the decision in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) was also considered, noting that taking the amendments as clarificatory, the same were applied to assessment years predating the amendment and that no reasons were assigned for the extension of the amendments to the double taxation avoidance agreement. It was noted thus:

> *"31. In a judgment by the Madras High Court in Verizon Communications Singapore Pte. Ltd. v. ITO (International Taxation) (2014) 361 ITR 575 (Mad), the court held the Explanations to be applicable to not only the domestic definition but also carried them to influence the meaning of royalty under article 12. Notably, in both cases, the clarificatory nature of the amendment was not questioned, but was instead applied squarely to assessment years predating the amendment. The crucial difference between the judgments however lies in the application of the amendments to the double taxation avoidance agreement. While TV Today (supra) recognises that the question will have to be decided and the submission argued, Verizon cites no reason for the extension of the amendments to the double taxation avoidance agreement."*

12.6.10. It would, thus, be clear that diverse opinions were recorded in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) on the one hand and *DIT v. New Skies Satellite BV* (supra) on the other. While in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra), Explanations 4, 5 and 6 to Section 9(1)(vi) of the Act were held as clarificatory and, therefore, applicable to assessments predating the amendment, a discordant note was struck in *DIT v. New Skies Satellite BV* (supra), albeit no final verdict on retrospective operation of newly inserted explanations was rendered and the court proceeded on the assumption that the Finance Act, 2012 inserting Explanations 5 and 6 to Section 9(1)(vi) of the Act was retrospective.

12.6.11. As we see, in *Verizon Communications Singapore PTE Ltd v. ITO* (supra), there is hardly any discussion to arrive at the conclusion that the newly inserted explanations are retrospective, being clarificatory. The relevant observations in this regard have already been referred to above. In fact, parties did join

issue whether the Finance Act, 2012 inserting Explanations 5 and 6 to Section 9(1)(vi) of the Act operated retrospectively. It was neither argued nor any discussion was made in the order to conclude that the amendment was retrospective. Noting the expression clarificatory; court held it to be applicable. As far as the decision in *DIT v. New Skies Satellite BV* (supra) is concerned, there also, though the issues were examined at some length, no conclusive opinion was rendered.

12.7.1. We shall now proceed to consider whether the Supreme Court decision in the case of *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra) overrules the view taken in *Verizon Communications Singapore PTE Ltd v. ITO* (supra).

12.7.2. In that case, the assessee, Engineering Analysis Centre of Excellence Pvt. Ltd, was a resident Indian end-user of shrink-wrapped computer software, directly imported from the United States of America. The case related to the assessment years 2001-2002 and 2002-2003. Applying Article 12(3) of the DTAA

between India and USA, and upon applying Section 9(1)(vi) of the Act, it was found that the assessee, in fact, transferred in the transaction between the parties copyright, which attracts payment of royalty and, thus, it was required that tax be deducted at source by the Indian importer and end-user, (assessee therein). Since that was not done for both the assessment years, assessee therein was held liable to pay the tax along with interest. The appeal before the CIT(A) was dismissed, however, the ITAT, on appeal, allowed the claim of the assessee therein. On further appeal before the High Court, it was held that though no application under Section 195(2) of the Act had been made, the resident Indian importer is liable to deduct tax at source, without more, under Section 195(1) of the Income Tax Act.

12.7.3. In that case, the amounts paid by the persons concerned, resident in India, to non-resident, foreign software suppliers, were held to constitute royalty, thereby constituting taxable income deemed to accrue in India under Section 9(1)(vi) of the Act and making it incumbent upon all such persons to deduct

tax at source and pay tax deductible at source under Section 195 of the Act.

12.7.4. We would, thus, find that in that case the issue essentially related to use of copyright. Though that was a case relating to copyright, the Supreme Court had an occasion to examine the statutory scheme of Section 9 of the Act, as also the effect of DTAA on taxability in such cases. Section 9(1)(vi) of the Act, including Explanations 4, 5 and 6 thereof, added by way of the Finance Act, 2012, also fell for consideration. The broad scheme of the Act with regard to taxability of income and treating certain payments as royalty was briefly outlined as below:

> *"25. The scheme of the Income Tax Act, insofar as the question raised before us is concerned, is that for income to be taxed under the Income Tax Act, residence in India, as defined by Section 6, is necessary in most cases. By Section 4(1), income tax shall be charged for any assessment year at any rate or rates, as defined by Section 2(37-A) of the Income Tax Act, in respect of the total income of the previous year of every person. Under Section 4(2), in respect of income chargeable under sub-section (1) thereof, income tax shall be deducted at*

source or paid in advance, depending upon the provisions of the Income Tax Act. Importantly, under Section 5(2) of the Income Tax Act, the total income of a person who is a non-resident, includes all income from whatever source derived, which accrues or arises or is deemed to accrue or arise to such person in India during such year. This, however, is subject to the provisions of the Income Tax Act. Certain income is deemed to arise or accrue in India, under Section 9 of the Income Tax Act, notwithstanding the fact that such income may accrue or arise to a non-resident outside India. One such income is income by way of royalty, which, under Section 9(1)(vi) of the Income Tax Act, means the transfer of all or any rights, including the granting of a licence, in respect of any copyright in a literary work."

12.7.5. The scope of various sub-sections, including sub-section (vi) to Section 9(1) of the Act, and introduction of what may be termed as "source rule" was explained thus:

"67. The insertion of sub-sections (v), (vi) and (vii) in Section 9(1) of the Income Tax Act, by way of an amendment through the Finance Act, 1976 [Act 66 of 1976, (w.e.f. 1-6-1976)] was to introduce source-based taxation for income in the hands of a non-resident by way of interest, royalty and fees for technical services. In Carborandum & Co. v. CIT, (1977) 2 SCC 862 : 1977

SCC (Tax) 391, this Court, applying residence-based rules of taxation, held that the technical service fees received by the non-resident assessee (relatable to Assessment Year 1957-1958) could only be deemed to accrue in India if such income could be attributed to a business connection in India. In the facts of that case, since no part of the foreign assessee's operations were carried on in India, the technical services being rendered wholly in foreign territory, it was held that no part of the technical service fees received by the foreign assessee accrued in India.

68. This position of law was altered by the Finance Act, 1976, which introduced a 'source-rule' to tax income by way of royalty in the hands of a non-resident, noted in the Memorandum explaining the provisions of the Finance Bill, 1976, as follows:

> *'38. "Source rule" regarding place of accrual of income by way of interest, royalty and fees for technical services.—A non-resident taxpayer is chargeable to tax in India in respect of income from whatever source derived which is received or is deemed to be received in India or which accrues or arises or is deemed to accrue or arise to him in India. The existing provisions in the Income Tax Act which provide that certain incomes will be deemed to accrue or arise in India are couched in general language. The*

absence of a clear-cut source rule sometimes creates uncertainty about the chargeability of certain types of incomes in the case of non-residents. In order to avoid any doubt or dispute in regard to the accrual of income by way of interest, royalty and fees for technical services in the case of non-residents, it is proposed to make certain provisions in the Income Tax Act clearly specifying the circumstances in which such income shall be deemed to accrue or arise in India.

***

40. Income by way of royalty payable by the Government will be deemed to accrue or arise in India. Royalty payable by a person who is resident in India will also be deemed to accrue or arise in India, except in cases where the royalty is payable for the transfer of any right or the use of any property or information or for utilising the services of the recipient for the purposes of a business or profession carried on outside India or for the purposes of making or earning any income from a source outside India. Royalty payable by a non-resident will be deemed to accrue or arise in India only in cases where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession

carried on by the non-resident in India or for the purposes of making or earning any income from any source in India.'"

12.7.6. The aforesaid case, though was with reference to copyright, the following pertinent observations were made:

"73. Even if we were to consider the ambit of "royalty" only under the Income Tax Act on the footing that none of the DTAAs apply to the facts of these cases, the definition of "royalty" that is contained in Explanation 2 to Section 9(1)(vi) of the Income Tax Act would make it clear that there has to be a transfer of "all or any rights" which includes the grant of a licence in respect of any copyright in a literary work. The expression "including the granting of a licence" in clause (v) of Explanation 2 to Section 9(1)(vi) of the Income Tax Act, would necessarily mean a licence in which transfer is made of an interest in rights "in respect of" copyright, namely, that there is a parting with an interest in any of the rights mentioned in Section 14(b) read with Section 14(a) of the Copyright Act. To this extent, there will be no difference between the position under the DTAA and Explanation 2 to Section 9(1)(vi) of the Income Tax Act."

12.7.7. In that case, the revenue sought application of the amendment made vide Finance Act, 2012 with retrospective effect

from 1.6.1976, which added Explanation 4 to Section 9(1)(vi) of the Act. Having noted the memorandum explaining the provisions in the Finance Bill, 2012 and upon consideration of the submissions made before it, broadly with regard to it being clarificatory of the position as it always stood since 1.6.1976, their Lordships in the Supreme Court examined the legal issue as below:

> "77. It is equally difficult to accept the learned Additional Solicitor General's submission that Explanation 4 to Section 9(1)(*vi*) of the Income Tax Act is clarificatory of the position as it always stood, since 1-6-1976, for which he strongly relied upon CBDT Circular No. 152 dated 27-11-1974. Quite obviously, such a circular cannot apply as it would then be explanatory of a position that existed even before Section 9(1)(*vi*) was actually inserted in the Income Tax Act vide the Finance Act, 1976. Secondly, insofar as Section 9(1)(*vi*) of the Income Tax Act relates to computer software, Explanation 3 thereof, refers to "computer software" for the first time with effect from 1-4-1991, when it was introduced, which was then amended vide the Finance Act, 2000. Quite clearly, Explanation 4 cannot apply to any right for the use of or the right to use computer software even before the term "computer software" was inserted in the statute. Likewise, even qua Section 2(*o*) of the Copyright Act, the term "computer software" was introduced for the first

time in the definition of a literary work, and defined under Section 2(*ffc*) only in 1994 (*vide* Act 38 of 1994).

78. Furthermore, it is equally ludicrous for the aforesaid amendment which also inserted Explanation 6 to Section 9(1)(*vi*) of the Income Tax Act, to apply with effect from 1-6-1976, when technology relating to transmission by a satellite, optic fibre or other similar technology, was only regulated by Parliament for the first time through the Cable Television Networks (Regulation) Act, 1995, much after 1976. For all these reasons, it is clear that Explanation 4 to Section 9(1)(*vi*) of the Income Tax Act is not clarificatory of the position as of 1-6-1976, but in fact, expands that position to include what is stated therein, vide the Finance Act, 2012."

12.7.8. The submission made by the revenue before the court that being covered by Explanation 4 to Section 9(1)(vi) of the Act, the persons liable to deduct tax at source under Section 195 of the Act ought to have deducted tax at source, on the footing that Explanation 4 existed in the statute book with effect from 1976, the court proceeded to examine whether the persons liable to deduct TDS under Section 195 of the Act can be held liable to deduct such sums at the time when Explanation 4 was not in the

statute book, all deductions liable to be made and the assessment years in question being prior to the year 2012. Apply two latin maxims *lex non cogit ad impossibilia* and *impotentia excusat legem*, the law expounded was as below:

> *"81. This question is answered by two Latin maxims, lex non cogit ad impossibilia i.e. the law does not demand the impossible and impotentia excusat legem i.e. when there is a disability that makes it impossible to obey the law, the alleged disobedience of the law is excused. Recently, in the judgment in Arjun Panditrao Khotkar v. Kailash Kushanrao Gorantyal, (2020) 7 SCC 1, delivered by this Court, this Court applied the said maxims in the context of the requirement of a certificate to produce evidence by way of electronic record under Section 65-B of the Evidence Act, 1872 and held that having taken all possible steps to obtain the certificate and yet being unable to obtain it for reasons beyond his control, the respondent in the facts of the case, was relieved of the mandatory obligation to furnish a certificate. In so holding, this Court referred to previous judgments dealing with the doctrine of impossibility and concluded as follows:*
>
> > *"47. However, a caveat must be entered here. The facts of the present case show that despite all efforts made by the respondents, both through the High Court*

and otherwise, to get the requisite certificate under Section 65-B(4) of the Evidence Act from the authorities concerned, yet the authorities concerned wilfully refused, on some pretext or the other, to give such certificate. In a fact-circumstance where the requisite certificate has been applied for from the person or the authority concerned, and the person or authority either refuses to give such certificate, or does not reply to such demand, the party asking for such certificate can apply to the court for its production under the provisions aforementioned of the Evidence Act, CPC or CrPC. Once such application is made to the court, and the court then orders or directs that the requisite certificate be produced by a person to whom it sends a summons to produce such certificate, the party asking for the certificate has done all that he can possibly do to obtain the requisite certificate. Two Latin maxims become important at this stage. The first is lex non cogit ad impossibilia i.e. the law does not demand the impossible, and impotentia excusat legem i.e. when there is a disability that makes it impossible to obey the law, the alleged disobedience of the law is excused. This was well put by this Court in Presidential Poll, In re [Presidential Poll, In re, (1974) 2 SCC 33] as follows:

> *'14. If the completion of election before the expiration of the term is not possible because of the death of the prospective candidate it is*

apparent that the election has commenced before the expiration of the term but completion before the expiration of the term is rendered impossible by an act beyond the control of human agency. The necessity for completing the election before the expiration of the term is enjoined by the Constitution in public and State interest to see that the governance of the country is not paralysed by non-compliance with the provision that there shall be a President of India.

15. The impossibility of the completion of the election to fill the vacancy in the office of the President before the expiration of the term of office in the case of death of a candidate as may appear from Section 7 of the 1952 Act does not rob Article 62(1) of its mandatory character. The maxim of law impotentia excusat legem is intimately connected with another maxim of law lex non cogit ad impossibilia. Impotentia excusat legem is that when there is a necessary or invincible disability to perform the mandatory part of the law that impotentia excuses. The law does not compel one to do that which one cannot possibly perform. "Where the law creates a duty or charge, and the party is disabled to perform it, without any default in him, and has no remedy over it, there the law will in general

excuse him." Therefore, when it appears that the performance of the formalities prescribed by a statute has been rendered impossible by circumstances over which the persons interested had no control, like the act of God, the circumstances will be taken as a valid excuse. Where the act of God prevents the compliance with the words of a statute, the statutory provision is not denuded of its mandatory character because of supervening impossibility caused by the act of God. (See Broom's Legal Maxims, 10th Edn. at pp. 162-63 and Craies on Statute Law, 6th Edn. at p. 268.)'

It is important to note that the provision in question in Presidential Poll, In re [Presidential Poll, In re, (1974) 2 SCC 33] was also mandatory, which could not be satisfied owing to an act of God, in the facts of that case. These maxims have been applied by this Court in different situations in other election cases — See Chandra Kishore Jha v. Mahavir Prasad, (1999) 8 SCC 266, at paras 17 and 21; Special Reference No. 1 of 2002, In re (Gujarat Assembly Election matter) [Special Reference No. 1 of 2002, In re (Gujarat Assembly Election matter), (2002) 8 SCC 237], at paras 130 and 151 and Raj Kumar Yadav v. Samir Kumar Mahaseth [Raj Kumar Yadav v. Samir Kumar Mahaseth, (2005) 3 SCC 601] , at paras 13 and 14.

48. These Latin maxims have also been applied in several other contexts by this Court. In Cochin State Power & Light Corpn. Ltd. v. State of Kerala [Cochin State Power & Light Corpn. Ltd. v. State of Kerala, (1965) 3 SCR 187 : AIR 1965 SC 1688], a question arose as to the exercise of an option of purchasing an undertaking by the State Electricity Board under Section 6(4) of the Electricity Act, 1910. The provision required a notice of at least 18 months before the expiry of the relevant period to be given by such State Electricity Board to the State Government. Since this mandatory provision was impossible of compliance, it was held that the State Electricity Board was excused from giving such notice, as follows : (Cochin State Power & Light case [Cochin State Power & Light Corpn. Ltd. v. State of Kerala, (1965) 3 SCR 187 : AIR 1965 SC 1688], SCR p. 193 : AIR pp. 1691-92, para 8)

> *'8. Sub-section (1) of Section 6 expressly vests in the State Electricity Board the option of purchase on the expiry of the relevant period specified in the licence. But the State Government claims that under sub-section (2) of Section 6 it is now vested with the option. Now, under sub-section (2) of Section 6, the State Government would be vested with the option only "where a State Electricity Board has not been constituted, or if constituted, does not elect*

to purchase the undertaking". It is common case that the State Electricity Board was duly constituted. But the State Government claims that the State Electricity Board did not elect to purchase the undertaking. For this purpose, the State Government relies upon the deeming provisions of sub-section (4) of Section 6, and contends that as the Board did not send to the State Government any intimation in writing of its intention to exercise the option as required by the sub-section, the Board must be deemed to have elected not to purchase the undertaking. Now, the effect of sub-section (4) read with sub-section (2) of Section 6 is that on failure of the Board to give the notice prescribed by sub-section (4), the option vested in the Board under sub-section (1) of Section 6 was liable to be divested. Sub-section (4) of Section 6 imposed upon the Board the duty of giving after the coming into force of Section 6 a notice in writing of its intention to exercise the option at least 18 months before the expiry of the relevant period. Section 6 came into force on 5-9-1959, and the relevant period expired on 3-12-1960. In the circumstances, the giving of the requisite notice of 18 months in respect of the option of purchase on the expiry of 2-12-1960, was impossible from the very commencement of

Section 6. The performance of this impossible duty must be excused in accordance with the maxim, lex non cogit ad impossibilia (the law does not compel the doing of impossibilities), and sub-section (4) of Section 6 must be construed as not being applicable to a case where compliance with it is impossible. We must, therefore, hold that the State Electricity Board was not required to give the notice under sub-section (4) of Section 6 in respect of its option of purchase on the expiry of 25 years. It must follow that the Board cannot be deemed to have elected not to purchase the undertaking under sub-section (4) of Section 6. By the notice served upon the appellant, the Board duly elected to purchase the undertaking on the expiry of 25 years. Consequently, the State Government never became vested with the option of purchasing the undertaking under sub-section (2) of Section 6. The State Government must, therefore, be restrained from taking further action under its notice, Ext. G, dated 20-11-1959.'

49. In Raj Kumar Dey v. Tarapada Dey [Raj Kumar Dey v. Tarapada Dey, (1987) 4 SCC 398], the maxim lex non cogit ad impossibilia was applied in the context of the applicability of a mandatory provision of the

Registration Act, 1908, as follows: (SCC pp. 402-403, paras 6-7)

> *'6. We have to bear in mind two maxims of equity which are well settled, namely, actus curiae neminem gravabit — An act of the court shall prejudice no man. In Broom's Legal Maxims, 10th Edn., 1939 at p. 73 this maxim is explained that this maxim was founded upon justice and good sense; and afforded a safe and certain guide for the administration of the law. The above maxim should, however, be applied with caution. The other maxim is lex non cogit ad impossibilia (Broom's Legal Maxims, p. 162) — The law does not compel a man to do that which he cannot possibly perform. The law itself and the administration of it, said Sir W. Scott, with reference to an alleged infraction of the revenue laws, must yield to that to which everything must bend, to necessity; the law, in its most positive and peremptory injunctions, is understood to disclaim, as it does in its general aphorisms, all intention of compelling impossibilities, and the administration of laws must adopt that general exception in the consideration of all particular cases.*

7. In this case indisputably during the period from 26-7-1978 to December 1982 there was subsisting injunction preventing the arbitrators from taking any steps. Furthermore, as noted before the award was in the custody of the court, that is to say, 28-1-1978 till the return of the award to the arbitrators on 24-11-1983, arbitrators or the parties could not have presented the award for its registration during that time. The award as we have noted before was made on 28-11-1977 and before the expiry of the four months from 28-11-1977, the award was filed in the court pursuant to the order of the court. It was argued that the order made by the court directing the arbitrators to keep the award in the custody of the court was wrong and without jurisdiction, but no arbitrator could be compelled to disobey the order of the court and if in compliance or obedience with court of doubtful jurisdiction, he could not take back the award from the custody of the court to take any further steps for its registration then it cannot be said that he has failed to get the award registered as the law required. The aforesaid two legal maxims — the law does not compel a man to do that which he cannot possibly perform and an act of the court shall prejudice no man would, apply with full vigour in the facts of this case and

if that is the position then the award as we have noted before was presented before the Sub-Registrar, Arambagh on 25-11-1983 the very next one day of getting possession of the award from the court. The Sub-Registrar pursuant to the order of the High Court on 24-6-1985 found that the award was presented within time as the period during which the judicial proceedings were pending that is to say, from 28-1-1978 to 24-11-1983 should be excluded in view of the principle laid down in Section 15 of the Limitation Act, 1963. The High Court [Tarapada Dey v. District Registrar, Hooghly, 1986 SCC OnLine Cal 101 : AIR 1987 Cal 107] , therefore, in our opinion, was wrong in holding that the only period which should be excluded was from 26-7-1978 till 20-12-1982. We are unable to accept this position. 26-7-1978 was the date of the order of the learned Munsif directing maintenance of status quo and 20-12-1982 was the date when the interim injunction was vacated, but still the award was in the custody of the court and there is ample evidence as it would appear from the narration of events hereinbefore made that the arbitrators had tried to obtain the custody of the award which the court declined to give to them.'

50. These maxims have also been applied to tenancy legislation — see B.P. Khemka (P) Ltd. v. Birendra Kumar Bhowmick [B.P. Khemka (P) Ltd. v. Birendra Kumar Bhowmick, (1987) 2 SCC 407] , SCC para 12, and have also been applied to relieve authorities of fulfilling their obligation to allot plots when such plots have been found to be unallottable, owing to the contravention of the Central statutes — see Hira Tikkoo v. State (UT of Chandigarh) [Hira Tikkoo v. State (UT of Chandigarh), (2004) 6 SCC 765] , SCC paras 23 and 24.

51. On an application of the aforesaid maxims to the present case, it is clear that though Section 65-B(4) is mandatory, yet, on the facts of this case, the respondents, having done everything possible to obtain the necessary certificate, which was to be given by a third party over whom the respondents had no control, must be relieved of the mandatory obligation contained in the said sub-section."

82. As a matter of fact, even under the Income Tax Act, the High Court of Bombay has taken a view, applying the aforestated maxims in the context of the provisions of the relevant DTAAs, to hold that persons are not obligated to do the impossible i.e. to apply a provision of a statute when it was not actually and factually on the statute book.

12.7.9. In the aforesaid decision, it was thus concluded as below:

> *"85. It is thus clear that the "person" mentioned in Section 195 of the Income Tax Act cannot be expected to do the impossible, namely, to apply the expanded definition of "royalty" inserted by Explanation 4 to Section 9(1)(vi) of the Income Tax Act, for the assessment years in question, at a time when such Explanation was not actually and factually in the statute."*

12.7.10. Therefore, it is clear position of law, as enunciated by the Supreme Court as aforesaid, that the Explanations added vide Finance Act, 2012 cannot be treated as clarificatory in nature, as if they were in the statute book since 1.6.1976, as the provisions are expansive in nature and, in substance, not merely clarificatory.

12.7.11. The aforesaid enunciation of law is applicable in the present case, because the assessments in question are in relation to taxability pertaining to finance years prior to introduction of Finance Act, 2012.

12.8.1. The view taken in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra) is that even if the assessee does not have an effective control over the equipment, the use of process will render payment liable to be treated as royalty was based on application of Explanations 4, 5 and 6 added by way of Finance Act, 2012 and we see from a reading of the said judgment, that the assessee's case based on decision in the case *Asia Satellite Telecommunications Private Limited v. DIT* (supra) and various rulings of the Authority on Advance Rulings was rejected by holding that such decisions are of no assistance in view of the amendment which was introduced by Finance Act, 2012 by insertion of Explanations 5 and 6.

12.8.2. In *Verizon Communications Singapore PTE Ltd v. ITO* (supra), the decision in the case of *Poompuhar Shipping Corporation Limited v. ITO* (supra), was relied upon, wherein for the purposes of determining whether the payments made constituted royalty, recourse was had to the meaning assigned to it

by taking into consideration newly inserted Explanations 4 and 5 under the Finance Act, 2012.

12.8.3. It was precisely on application of the newly inserted Explanations vide Finance Act, 2012, whereafter it became irrelevant whether or not the assessee has control or possession of the scientific equipment, that the claim of the assessee therein that payment made was for service and it was not a case of transfer was rejected. Therefore, to that extent, the decision in the case of *Verizon Communications Singapore PTE Ltd v. ITO* (supra), in our considered opinion, stands overruled and cannot be relied upon as a precedent.

12.9. But for the application of newly inserted Explanations 4, 5 and 6 under Finance Act, 2012, the payment made in the present case by the assessee to Sprint USA for IPLC would not constitute 'royalty' within the meaning of that expression as provided under clause (iva) to Explanation 2 to Section 9(1)(vi) of the Act, in as much as it does not partake nature of consideration for the use or

right to use a scientific equipment, applying the principle laid down in *Asia Satellite Telecommunications Private Limited v. DIT* (supra).

13. Accordingly, the questions of law on this issue are answered in favour of the assessee and against the revenue.

FOURTH SUBSTANTIAL QUESTION OF LAW IN TCA No.277 OF 2016 AND THIRD SUBSTANTIAL QUESTION OF LAW IN TCA No.278 of 2016

14. This issue pertains to the finding rendered by the ITAT that amount paid by the appellant to Sprint USA should be subject to deduction of tax at source.

15.1. Questioning the legality of the said finding, learned counsel for the assessee submitted that, *assuming arguendo*, even if the payments are determined to be royalty in nature, no disallowance under Section 40 of the Act can be made in the hands of the assessee in view of the non-discrimination article of the India-USA DTAA. He added that Article 26(3) of the India-USA DTAA unequivocally provides that payments, *inter alia,* royalty paid

to a resident of USA shall be allowable as a deduction in determining the taxable income of a resident of India under the same conditions as if they were paid to a resident of India. He submitted that there should be parity between the deductibility of expenses whether they are paid to residents of India or residents of USA and the same conditions should apply to the deductibility of expenses for both.

15.2. Learned counsel for the assessee instantiated the two separate provisions for disallowance of expenses, i.e., Section 40(a)(ia) and Section 40(a)(i), by submitting that, if the assessee had made a payment in the nature of royalty and had failed to deduct applicable tax on the same, then there is a lack of parity since: (a) the payment made to non-resident would be liable to disallowance, since Section 40(a)(i) provides for disallowance of payments in the nature of royalty; and (b) the payment made to Indian resident would not be liable to disallowance, since Section 40(a)(ia) does not cover payments in the nature of royalty. This, according to the assessee, is tantamount to gross discrimination

that is sought to be nullified under Article 26 of the India-USA DTAA.

15.3. Referring to Article 26(3) of the India-USA DTAA, it is submitted that the language in which it is couched makes it clear that the deduction in the hands of Resident payer on payment to a US Resident shall be under the same conditions as that of a payment made to an Indian Resident. In the present case, the disallowance is made only in respect of payment to a non-resident. He added that the mere fact that there was no provision under the Act mandating deduction of tax at source in respect of payment to a resident does not alter the applicability of Article 26(3).

15.4. In support of the submissions on this issue, learned counsel for the assessee relied upon the following decisions:

(a)*CIT v. Herbalife International India (P) Ltd*[14];

(b)*CIT v. Mitsubishi Corporation India (P) Ltd*[15];

(c)*Berger Paints India Ltd v. Commissioner of Income*

14 (2016) 384 ITR 276 (Delhi)
15 (2024) 463 ITR 335 (Delhi)

Tax[16]; and

(d)*Union of India v. Kaumudini Narayan Dalal*[17];

16.1. In rebuttal, learned Standing Counsel submitted that until 13.07.2006, there was no requirement to deduct tax on royalty payments made to a resident in India. Section 194J Act was amended with effect from 13.07.2006, in which royalty was also included. In the same year, vide Finance Act 2006, Section 40(a)(ia) of the Act was also amended by including the term royalty for the purpose of disallowance of the payments made to a resident for failure to deduct tax under Section 194J of the Act. Therefore, when there was no necessity at all to deduct tax on payments made to a resident until assessment year 2006-2007, the assessee cannot rely on a non-existent requirement during the assessment years 2003-2004 and 2004-2005 and compare that with a positive requirement under the Act for deducting tax by the assessee while making payments to a non-resident.

16 (2004) 266 ITR 99 (SC)
17 (2001) 249 ITR 219 (SC)

16.2. It is his submission that it is a policy decision of a sovereign State to decide as to when a particular domestic withholding tax has to be introduced on any particular payment and it cannot be dictated by any other State, far less, a taxpayer. Therefore, the reliance placed by learned counsel for assessee on two Delhi High Court judgments, referred supra, is misplaced, as the said decisions did not consider introduction of royalty withholding tax requirement in Section 194J of the Act only from assessment year 2006-2007.

16.3. In any case, it is submitted that discrimination, as long as it is fair, logical and reasonable, cannot be treated as unfair discrimination. The recovery of tax from a non-resident on the payments received will almost be impossible and, therefore, unless and until a resident payer deducts the taxes on the payments made to a non-resident, such taxes will have to be foregone once and for all. When such a reasonable basis is the reason for invoking Section 40(a)(i) of the Act on the assessee for the relevant assessment years, that too, when it need not shell its money as taxes, as it only

has to withhold from the payments made to a non-resident, it cannot be complained that even if it does not deduct tax, it should not come within the ambit of Section 40(a)(i) of the Act.

17.1. Though we have held that payment made by the assessee to Sprint USA for use of undersea cables does not constitute royalty, this question of law being equally important as it involves the issue of taxability with reference to the provisions of the Act and DTAA and its interpretation, we shall proceed to decide the same.

17.2. The provisions of Section 90(2) of the Act have already been referred to herein above to highlight that where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that

assessee.

17.3. It is undisputed that there exists in operation a DTAA between India and USA. The Tribunal held that provision qua 'royalty' under DTAA and the Act are *pari materia* and, therefore, the payment made by the assessee was treated as royalty and the assessee's claim of disallowance under Section 40(a)(i) of the Act was rejected.

17.4. Before referring to the relevant articles of DTAA between India and USA, as applicable in the present case, it is relevant to refer to the pertinent observations made by the Delhi High Court in *DIT v. New Skies Satellite BV* (supra) and the conceptual framework of DTAA, its interpretation and taxability as royalty of certain payments made:

> *"24. International double taxation typically occurs when two jurisdictions claim the right to tax the same tax entity or subject with respect to the same income for the same period. Indisputably, taxation of income twice over by two different jurisdictions has an adverse impact on the movement of goods and services across international*

borders. For this purpose, jurisdictions with concurrent taxing rights enter into double taxation avoidance agreement, which set rules that attempt, at the very least, theoretically, to eliminate a double incidence of tax. The States therefore limit their legitimate taxing powers in favour of the other State, by either agreeing not to tax a certain income, which has been reserved for the other Contracting State, or taxing that income to a limited extent. These treaties therefore have the effect of restraining the operation of the domestic taxing laws of a Contracting State. Justifiably, the balance between the domestic law of the Contracting State and its obligations under the treaty is a delicate matter worthy of critical consideration and is often the subject of Parliamentary legislation. In this context, section 90 of the Act of 1961, which is law relatable to article 253 of the Constitution, read with Entries 13, 14 and 82 of List 1 of the Seventh Schedule holds the field. It states that where the Central Government has entered into a double taxation avoidance agreement, then in relation to the taxpayer who is contemplated by such agreement, the provisions of the Act shall apply to the extent that they are more beneficial to the assessee.

25. The underlying presumption of a double taxation avoidance agreement being that in the absence of such agreement, the income in question is taxable in both jurisdictions as under their domestic laws, whenever

courts are confronted with taxability of an income in the context of such an agreement, they must as a matter of course, first decide whether the income in issue is taxable under domestic legislation, specifically the Act. It is only when that issue is answered in the affirmative that the court turns its attention to the tax convention in issue, to ascertain primarily whether the terms of the convention exempt that particular income from being taxed under the Act.

...

41. This court is of the view that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend in operation to the terms of an international treaty. In other words, a clarificatory or declaratory amendment, much less one which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment. In the context of international law, while not every attempt to subvert the obligations under the treaty is a breach, it is nevertheless a failure to give effect to the intended trajectory of the treaty. Employing interpretive amendments in domestic law as a means to imply contoured effects in the enforcement of treaties is one such attempt, which falls just short of a breach, but is nevertheless, in the opinion of this court, indefensible."

17.5. The nature and the impact of treaties on taxability, as considered by the Supreme Court in the case of *Union of India v. AzadiBachao Andolan*[18] was relied upon by the Delhi High Court in the aforesaid decision as below:

> *"42. It takes little imagination to comprehend the extent and length of negotiations that take place when two nations decide to regulate the reach and application of their legitimate taxing powers. In Union of India v. Azadi Bachao Andolan (2003) 263 ITR 706 (SC), where the Indo-Mauritius Double Taxation Avoidance Convention was before the Supreme Court, the court said the following of the essential nature of these treaties:*
>
> > *"132. An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including one for double taxation relief is that treaties are negotiated and entered into at a political level and have several considerations as their bases. Commenting on this aspect of the matter, David R. Davis in Principles of International Double Taxation Relief, (see David R. Davis, Principles of International Double Taxation Relief, Pg.4 (London Sweet and Maxwell, 1985)) points out*

18*(2003) 263 ITR 706*

that the main function of a Double Taxation Avoidance Treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. It is observed (vide para. 1.06):

'The benefits and detriments of a double taxation treaty will probably only be truly reciprocal where the flow of trade and investment between treaty partners is generally in balance. Where this is not the case, the benefits of the treaty may be weighted more in favour of one treaty partner than the other, even though the provisions of the treaty are expressed in reciprocal terms. This has been identified as occurring in relation to tax treaties between developed and developing countries, where the flow of trade and investment is largely one way.

Because treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and

sufficient quid pro quo is obtained by both sides.'"

17.6. In the context of a situation, where there does exist a definition of the term within the DTAA, the legal position was explained by the Delhi High Court in *DIT v. New Skies Satellite BV* (supra) as under:

> *"50. ... This court's finding is in the context of the second situation, where there does exist a definition of a term within the double taxation avoidance agreements. When that is the case, there is no need to refer to the laws in force in the Contracting States, especially to deduce the meaning of the definition under the double taxation avoidance agreements and the ultimate taxability of the income under the agreement. That is not to say that the court may be inconsistent in its interpretation of similar definitions. What that does imply however, is that just because there is a domestic definition similar to the one under the double taxation avoidance agreement, amendments to the domestic law, in an attempt to contour, restrict or expand the definition under its statute, cannot extend to the definition under the Double Taxation Avoidance Agreement. In other words, the domestic law remains static for the purposes of the double taxation avoidance agreement. The court in Sanofi (supra) had also held similarly:*

"We are in agreement with the petitioners and in the light of our preceding analyses, discern no textual, grammatical or syntactic ambiguity in article 14(5), warranting an interpretive recourse. In the circumstances, invoking the provisions of article 3(2) by an artificial insemination of ambiguity (to accommodate an expanded meaning to the double tax avoidance agreement provision), would be contrary to good faith interpretation. A further problematic of contriving an ambiguity to unwarrantedly invite application of domestic law of a Contracting State would be that while India would interpret an undefined double taxation avoidance agreement provision according to the provisions of the Act, France could do so by reference to its tax code. As a consequence, the purpose of entering into a treaty with a view to avoiding double taxation of cross-border transactions would be frustrated."

17.7. Referring to another decision of the Delhi High Court, the principle applicable was explained thus:

"52. Thus, an interpretive exercise by Parliament cannot be taken so far as to control the meaning of a word expressly defined in a treaty. Parliament, supreme as it

may be, is not equipped, with the power to amend a treaty. It is certainly true that law laid down by Parliament in our domestic context, even if it were in violation of treaty principles, is to be given effect to; but where the State unilaterally seeks to amend a treaty through its Legislature, the situation becomes one quite different from when it breaches the treaty. In the latter case, while internationally condemnable, the State's power to breach very much exists; courts in India have no jurisdiction in the matter, because in the absence of enactment through appropriate legislation in accordance with article 253 of the Constitution, courts do not possess any power to pronounce on the power of the State to enact a law contrary to its treaty obligations. The domestic courts, in other words, are not empowered to legally strike down such action, as they cannot dictate the executive action of the State in the context of an international treaty, unless of course, the Constitution enables them to. That being said, the amendment to a treaty is not on the same footing. Parliament is simply not equipped with the power to, through domestic law, change the terms of a treaty. A treaty to begin with, is not drafted by Parliament; it is an act of the executive. Logically therefore, the executive cannot employ an amendment within the domestic laws of the State to imply an amendment within the treaty. Moreover, a treaty of this nature is a carefully negotiated economic bargain between two States. No one party to the treaty

can ascribe to itself the power to unilaterally change the terms of the treaty and annul this economic bargain. It may decide to not follow the treaty, it may chose to renege from its obligations under it and exit it, but it cannot amend the treaty, especially by employing domestic law. The principle is reciprocal. Every treaty entered into be the Indian State, unless self-executory, becomes operative within the State once Parliament passes a law to such effect, which governs the relationship between the treaty terms and the other laws of the State. It then becomes part of the general conspectus of domestic law. Now, if an amendment were to be effected to the terms of such treaty, unless the existing operationalising domestic law states that such amendments are to become automatically applicable, Parliament will have to by either a separate law, or through an amendment to the original law, make the amendment effective. Similarly, amendments to domestic law cannot be read into treaty provisions without amending the treaty itself."

17.8. It was also held in *DIT v. New Skies Satellite BV* (supra) that when the technical terms used in the DTAAs are the same which appear in Section 9(1)(vi) of the Act, for better understanding all these very terms, OECD commentary can always be relied upon, by relying upon various judgments of the Apex

Court emphasizing that the well-settled internationally accepted meaning and interpretation placed on identical or similar terms employed in various DTAAs should be followed by the courts in India when it comes to construing similar terms occurring in the Act.

17.9. India's change in position to the OECD Commentary was held not to influence the interpretation of the words defining royalty as they stood on the date and the only manner in which such change in position is relevant is if such change is incorporated into the agreement itself and not otherwise. A change in executive position cannot bring about a unilateral legislative amendment into a treaty concluded between two sovereign States. Therefore, mere amendment to Section 9(1)(vi) of the Act cannot result in a change and it is imperative that such amendment is brought about in the agreement as well.

17.10. Having held that the Finance Act will not effect Article 12 of the DTAA, it was a consequent finding that determinative

interpretation given to the word 'royalty' in *Asia Satellite Telecommunications Private Limited v. DIT* (supra), where definitions were, in fact, *pari materia* will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involved a DTAA, unless the said DTAA is amended jointly by both the parties to incorporate income from data transmission services as partaking the nature of royalty, or amend the definition in a manner so that such income automatically becomes royalty.

17.11. The aforesaid principles with regard to application of DTAAs when the same term is used both in the Act and DTAAs was examined by the Apex Court in *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra). The appeals before the Supreme Court concerned the DTAAs between India and several countries/ parties, including USA, as clearly stated in paragraph 40 of the said judgment. It was then observed that each of these DTAAs (including agreement with USA) is based on the OECD Model Tax Convention on Income and on Capital, and are, therefore,

substantially similar, if not identical, in respect of the provisions concerning "business profits" and "royalties".

17.12. The Supreme Court considered various provisions of India-Singapore DTAA, including Article 12 captioned "Royalties and Fees for Technical Services". It considered the provisions contained in DTAAs and Explanation 4 to Section 90 of the Act to hold that the definition of the term "royalties" shall have the meaning assigned to it by the DTAA, meaning thereby that the expression "royalty", when occurring in Section 9 of the Act, has to be construed with reference to Article 12 of the DTAA. The position clarified by the CBDT Circular dated 2.4.1982 was also referred. The observations in this regard are as below:

> *"42. The subject-matter of each of the DTAAs with which we are concerned is income tax payable in India and a foreign country. Importantly, as is now reflected by Explanation 4 to Section 90 of the Income Tax Act and under Article 3(2) of the DTAA, the definition of the term "royalties" shall have the meaning assigned to it by the DTAA, meaning thereby that the expression "royalty", when occurring in Section 9 of the Income Tax Act, has to be construed with reference to Article 12 of the DTAA.*

This position is also clarified by CBDT Circular No. 333 dated 2-4-1982, [F. No. 506/42/81-FTD.] which states as follows:

> *"Circular No. 333 dated 2-4-1982.*
> *Specific provisions made in double taxation avoidance agreement — Whether it would prevail over general provisions contained in the Income Tax Act*
>
> *1. It has come to the notice of the Board that sometimes effect to the provisions of double taxation avoidance agreement is not given by the assessing officers when they find that the provisions of the agreement are not in conformity with the provisions of the Income Tax Act, 1961.*
> *2. The correct legal position is that where a specific provision is made in the double taxation avoidance agreement, that provisions will prevail over the general provisions contained in the Income Tax Act. In fact that the double taxation avoidance agreements which have been entered into by the Central Government under Section 90 of the Income Tax Act, also provide that the laws in force in either country will continue to govern the assessment and taxation of income in the respective countries except where provisions*

to the contrary have been made in the agreement.

3. Thus, where a double taxation avoidance agreement provides for a particular mode of computation of income, the same should be followed, irrespective of the provisions in the Income Tax Act. Where there is no specific provision in the agreement, it is basic law i.e. the Income Tax Act, that will govern the taxation of income."

43. Thus, by virtue of Article 12(3) of the DTAA, royalties are payments of any kind received as consideration for "the use of, or the right to use, any copyright" of a literary work, which includes a computer program or software."

17.13. At this stage, we may note that the provisions contained in Article 3(2) and Article 12 of the DTAA under consideration before the Supreme Court (India-Singapore DTAA) are similar, if not identical, particularly with regard to general definitions of Article 3(2) and Article 12(3) as regards the meaning of the term "royalities", except with the difference that that case related to use of a copyright. There Lordships proceeded to

consider in detail the applicability of the provisions of the DTAA, particularly with reference to India-USA DTAA. The definition of royalty in the DTAA vis-a-vis the Act was gone into in detail and then the following legal principle was enunciated:

> *"100. Also, any ruling on the more expansive language contained in the Explanations to Section 9(1)(vi) of the Income Tax Act would have to be ignored if it is wider and less beneficial to the assessee than the definition contained in the DTAA, as per Section 90(2) of the Income Tax Act read with Explanation 4 thereof, and Article 3(2) of the DTAA. Further, the expression "copyright" has to be understood in the context of the statute which deals with it, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA. For all these reasons, the determination of the AAR in Citrix Systems Asia Pacific Pty. Ltd. v. CIT, 2012 SCC OnLine AAR-IT 4 : (2012) 343 ITR 1, does not state the law correctly and is thus set aside."*

17.14. The interpretation of Treaties, OECD Commentary and the revenue's own understanding was also considered in detail as below:

"145. The DTAAs that have been entered into by India with other Contracting States have to be interpreted liberally with a view to implement the true intention of the parties. This Court, in Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1, put it thus:

> *"98. In John N. Gladden v. Her Majesty the Queen [85 DTC 5188 at p. 5190] the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed:*
> *'Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated insofar as the particular item under consideration is concerned.'*
>
> *Interpretation of treaties*
> *130. The principles adopted in interpretation of treaties are not the same as those in interpretation of a statutory legislation. While commenting on the interpretation of a treaty imported into a municipal law, Francis Bennion observes:*
> *'With indirect enactment, instead of the substantive legislation taking the well-known*

form of an Act of Parliament, it has the form of a treaty. In other words, the form and language found suitable for embodying an international agreement become, at the stroke of a pen, also the form and language of a municipal legislative instrument. It is rather like saying that, by Act of Parliament, a woman shall be a man. Inconveniences may ensue. One inconvenience is that the interpreter is likely to be required to cope with disorganised composition instead of precision drafting. The drafting of treaties is notoriously sloppy usually for a very good reason. To get agreement, politic uncertainty is called for.

… The interpretation of a treaty imported into municipal law by indirect enactment was described by Lord Wilberforce as being "unconstrained by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptation. This echoes the optimistic dictum of Lord Widgery, C.J. that the words 'are to be given their general meaning, general to lawyer and layman alike … the meaning of the diplomat rather than the lawyer" [Francis Bennion, Statutory Interpretation, 2nd Edn. (Butterworths, 1992) p. 461.] .'

131. An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including one for double taxation relief, is that treaties are negotiated and entered into at a political level and have several considerations as their bases. Commenting on this aspect of the matter, David R. Davis in Principles of International Double Taxation Relief [David R. Davis, Principles of International Double Taxation Relief (Sweet & Maxwell, London 1985) p.4.], points out that the main function of a Double Taxation Avoidance Treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. It is observed (vide Para 1.06):

'The benefits and detriments of a double tax treaty will probably only be truly reciprocal where the flow of trade and investment between treaty partners is generally in balance. Where this is not the case, the benefits of the treaty may be weighed more in favour of one treaty partner than the other, even though the

provisions of the treaty are expressed in reciprocal terms. This has been identified as occurring in relation to tax treaties between developed and developing countries, where the flow of trade and investment is largely one-way.

Because treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient quid pro quo is obtained by both sides.' And, finally, in Para 1.08:

'Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally.' "

146. Further, the House of Lords in Ostime (Inspector of Taxes) v. Australian Mutual Provident Society [1959] AC 259 by a judgment dated 16.7.1959 remarked upon, what it termed the "international tax language" of bilateral taxation agreements, as follows : (AC p. 480)

"… Bilateral agreements for regulating some of the problems of double taxation began, at any rate so far as the United Kingdom was

concerned, in 1946. The form employed, which, for obvious reasons, employs similar forms and similar language in all agreements, is derived, I believe, from a set of model clauses proposed by the financial commission of the League of Nations. The aim is to provide by treaty for the tax claims of two governments, both legitimately interested in taxing a particular source of income either by resigning to one of the two the whole claim or else by prescribing the basis on which the tax claim is to be shared between them. For our purpose it is convenient to note that the language employed in this agreement is what may be called international tax language and that such categories as "enterprise", "commercial or industrial profits" and "permanent establishment" have no exact counterpart in the taxing code of the United Kingdom."

147. All the DTAAs with which we are concerned, have, as their starting point, either the OECD Model Tax Convention on Income and Capital ["OECD Model Tax Convention"] and/or the United Nations Model Double Taxation Convention between Developed and Developing Countries ["UN Model Convention"] insofar as the taxation of royalty for parting with copyright is concerned."

17.15. In *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra), the Supreme Court examined the OECD Model Tax Convention and held thus:

> *"148. The OECD Model Tax Convention speaks of the importance of the OECD Commentary, as follows:*
>
> > *"2. It has long been recognised among the member countries of the Organisation for Economic Cooperation and Development that it is desirable to clarify, standardise, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation. These countries have also long recognised the need to improve administrative cooperation in tax matters, notably through exchange of information and assistance in collection of taxes, for the purpose of preventing tax evasion and avoidance.*
> >
> > *3. These are the main purposes of the OECD Model Tax Convention on Income and on Capital, which provides a means of settling on a uniform basis the most common problems that arise in*

the field of international juridical double taxation. As recommended by the Council of OECD, member countries, when concluding or revising bilateral conventions, should conform to this Model Convention as interpreted by the Commentaries thereon and having regard to the reservations contained therein and their Tax Authorities should follow these Commentaries, as modified from time to time and subject to their observations thereon, when applying and interpreting the provisions of their bilateral tax conventions that are based on the Model Convention.

***

29.2. Similarly, taxpayers make extensive use of the Commentaries in conducting their businesses and planning their business transactions and investments. The Commentaries are of particular importance in countries that do not have a procedure for obtaining an advance ruling on tax matters from the tax administration as the Commentaries may be the only available source of interpretation in that case."

(OECD Model Tax Convention 2017 — Condensed Version)

149. The OECD Model Tax Convention, in Article 12

thereof, defines the term "royalties" as follows:

"Article 12

ROYALTIES

***

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

150. When the definition of "royalties" is seen in all the DTAAs that we are concerned with, it is found that "royalties" is defined in a manner either identical with or similar to the definition contained in Article 12 of the OECD Model Tax Convention. This being the case, the OECD Commentary on the provisions of the OECD Model Tax Convention then becomes relevant. The OECD Commentary has been referred to and relied upon in several earlier judgments. See:

(i) Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1, at pp. 42-43;

(ii) Formula One World Championship Ltd. v. CIT, (2017) 15 SCC 602, at pp. 629-30; and

(iii) CIT v. E-Funds IT Solution Inc., (2018) 13 SCC 294] , at pp. 322-23."

17.16. The position taken by India (in the capacity of an OECD non-member) with regard to Article 12 of the OECD Model Tax Convention and the OECD Commentary, as relied upon by the revenue, was not accepted as the determinative factor and, in this regard, the legal position explained by the Delhi High Court in the case of *DIT v. New Skies Satellite BV* (supra) was affirmed holding that mere positions taken with respect to the OECD Commentary do not alter the DTAA's provisions, unless it is actually amended by way of bilateral re-negotiation. The following are the pertinent observations in this regard:

> *"155. In DIT v. New Skies Satellite BV [2016] 68 taxmann.com 8 ["New Skies Satellite"], a Division Bench of the High Court of Delhi correctly observed that mere positions taken with respect to the OECD Commentary do not alter the DTAA's provisions, unless it is actually amended by way of bilateral re-negotiation. This was put thus:*
>
> > *"68. On a final note, India's change in position to the OECD Commentary cannot be a fact that influences the interpretation of the words defining royalty as they stand today. The only manner in which such change in position can be*

relevant is if such change is incorporated into the agreement itself and not otherwise. A change in executive position cannot bring about a unilateral legislative amendment into a treaty concluded between two sovereign States. It is fallacious to assume that any change made to domestic law to rectify a situation of mistaken interpretation can spontaneously further their case in an international treaty. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change. It is imperative that such amendment is brought about in the agreement as well. Any attempt short of this, even if it is evidence of the State's discomfort at letting data broadcast revenues slip by, will be insufficient to persuade this Court to hold that such amendments are applicable to the DTAAs."

156. It is significant to note that after India took such positions qua the OECD Commentary, no bilateral amendment was made by India and the other Contracting States to change the definition of royalties contained in any of the DTAAs that we are concerned with in these appeals, in accordance with its position. As a matter of fact, DTAAs that were amended subsequently, such as the Convention between the Republic of India and the Kingdom of Morocco for the Avoidance of Double Taxation and the Prevention of

Fiscal Evasion with respect to Taxes On Income, [Notification: No. GSR 245(E), dated 15-3-2000.] ["India-Morocco DTAA"], which was amended on 22-10-2019, [Amended by Notification No. S.O. 3789(E) [No.84/2019/ F.No.503/09/2009-FTD-II], dated 22-10-2019, incorporated a definition of royalties, not very different from the definition contained in the OECD Model Tax Convention, as follows:

> *"The term "royalties" as used in this Article means:*
> *(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or recordings on any means of reproduction for use for radio or television broadcasting, any patent, trade mark, design or model, plan, computer software program, secret formula or process, or for information concerning industrial, commercial or scientific experience; and*
>
> *(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment"*
>
> *(Article 12.3)*

157. Similarly, though the India-Singapore DTAA came into force on 8-8-1994, it has been amended several times, including on 1-9-2011 [Notification No. S.O. 2031(E).] and 23-3-2017 [Notification No. S.O. 935(E).] However, the definition of "royalties" has been retained without any changes. Likewise, the Convention between the Government of the Republic of India and the Government of Mauritius for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains and for the Encouragement of Mutual Trade and Investment, [Notification No. GSR 920(E).] ["India-Mauritius DTAA"] was entered into on 6-12-1983, and was amended subsequently on 10-8-2016, [Notification No. S.O. 2680(E) (No. 68/2016 (F.No.500/3/2012-FTD-II).] without making any change to the definition of "royalties".

158. It is thus clear that the OECD Commentary on Article 12 of the OECD Model Tax Convention, incorporated in the DTAAs in the cases before us, will continue to have persuasive value as to the interpretation of the term "royalties" contained therein.

159. Viewed from another angle, persons who pay TDS and/or assessees in the nations governed by a DTAA have a right to know exactly where they stand in respect of the treaty provisions that govern them. Such persons

and/or assessees can thus place reliance upon the OECD Commentary for provisions of the OECD Model Tax Convention, which are used without any substantial change by bilateral DTAAs, in the absence of judgments of municipal courts clarifying the same, or in the event of conflicting municipal decisions. From this point of view also, the OECD Commentary is significant, as the Contracting States to which the persons deducting tax/assessees belong, can conclude business transactions on the basis that they are to be taxed either on income by way of royalties for parting with copyright, or income derived from licence agreements which is then taxed as business profits depending on the existence of a PE in the Contracting State."

17.17. In *Engineering Analysis Centre of Excellence Pvt. Ltd v. CIT* (supra), it was then concluded as below:

"176. The conclusions in the aforestated paragraph have no direct relevance to the facts at hand as the effect of Section 90(2) of the Income Tax Act, read with Explanation 4 thereof, is to treat the DTAA provisions as the law that must be followed by Indian courts, notwithstanding what may be contained in the Income Tax Act to the contrary, unless more beneficial to the assessee."

17.18. The legal position as adumbrated by the Supreme Court herein above would leave no manner of doubt that while determining taxability in cases where payment has been made to a non-resident, the definition of term 'royalty' as contained in DTAA can be determinative factor, unless the provisions contained in the Act, to the contrary, are more beneficial to the assessee. It is, therefore, clear that the amendments which were made by the Finance Act, 2012 by inserting Explanations 4, 5 and 6 would not come to the aid of the revenue. The conclusion, therefore, has to be that the payment made by the assessee to Sprint USA would not constitute royalty.

17.19. There is another angle from which the taxability aspect can be looked into. Learned counsel for the assessee has rightly relied upon non-discrimination clause in Article 26(3) of the DTAA between India and USA, which reads as below:

> *"Article 26: Non-discrimination*
>
> *...*
>
> *3. Except where the provisions of paragraph 1 of article 9 (Associated Enterprises), paragraph 7 of article 11 (Interest), or paragraph 8 of article 12 (Royalties and*

Fees for Included Services) apply, interest, royalties, and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State."

17.20. If we look into the provisions contained in Section 40 of the Act along with Article 26(3) of the India-USA DTAA, it is clear that deduction in the hands of the resident on payment to a USA resident shall be on the same conditions as that of a payment made to Indian resident. In the present case, the disallowance was only in respect of payment made to non-resident. On this score, the assessee has correctly placed reliance upon the decisions in the *Commissioner of Income-tax v. Herbalife International India (P) Ltd*[19], and *Commissioner of Income-tax v. Mitsubishi Corporation India (P) Ltd*[20].

17.21. In the decision in *Commissioner of Income-tax v. Herbalife International India (P) Ltd* (supra), identical issue was

19*(2016) 384 ITR 276 (Delhi)*
20*(2024) 463 ITR 335 (Delhi)*

considered by the Delhi High Court and it was held that Section 40(a)(i) of the Act is discriminatory and not applicable in terms of Article 26(3) of the India-USA DTAA. It was held as below:

> *"56. The argument of the Revenue also overlooks the fact that the condition under which deductibility is disallowed in respect of payments to non-residents, is plainly different from that when made to a resident. Under section 40(a)(i), as it then stood, the allowability of the deduction of the payment to a non-resident mandatorily required deduction of tax at the time of payment. On the other hand, payments to residents were neither subject to the condition of deduction of tax at source nor, naturally, to the further consequence of disallowance of the payment as deduction. The expression "under the same conditions" in article 26(3) of the Double Taxation Avoidance Agreement clarifies the nature of the receipt and conditions of its deductibility. It is relatable not merely to the compliance requirement of deduction of tax at source. The lack of parity in the allowing of the payment as deduction is what brings about the discrimination. The tested party is another resident Indian who transacts with a resident making payment and does not deduct tax at source and therefore in whose case there would be no disallowance of the payment as deduction because tax was not deducted at source. Therefore, the consequence of non-deduction of tax at source when the payment is to a non-resident has an*

adverse consequence to the payer. Since it is mandatory in terms of section 40(a)(i) for the payer to deduct tax at source from the payment to the non-resident, the latter receives the payment net of the tax deducted at source. The object of article 26(3) of the Double Taxation Avoidance Agreement was to ensure non- discrimination in the condition of deductibility of the payment in the hands of the payer where the payee is either a resident or a non-resident. That object would get defeated as a result of the discrimination brought about qua non-resident by requiring the tax to be deducted while making payment of fees for technical services in terms of section 40(a)(i) of the Act."

17.22. Similar is the decision in the case of *Commissioner of Income-tax v. Mitsubishi Corporation India (P) Ltd* (supra).

17.23. The submission of the revenue that until 13.07.2006 there was no requirement to deduct tax on royalty payments made to a resident in India and only by way of amendment under Section 194J Act with effect from 13.07.2006 royalty was also included, does not alter the legal position in the light of the above decision.

18. This question of law is answered in favour of the assessee and against the revenue.

FIFTH SUBSTANTIAL QUESTION OF LAW IN T.C.A.No.277 of 2016

19. For the impugned AY 2003-04, the assessee earned miscellaneous income in the nature of interest on loan given to employees and sale of scrap and claimed deduction under Section 10A/10B of the Act, since the same is derived from the eligible undertaking of the assessee. The Assessing Officer has denied the claim of the assessee by stating that the miscellaneous income does not have a direct nexus with the business of the eligible undertaking. The said order was upheld by the CIT(A), but was not adjudicated by the ITAT in the impugned order, though a specific ground was raised.

20.1. Learned counsel for the assessee, relying upon the decisions in *Commissioner of Income-tax v. Sankhya Technologies (P) Ltd*[21] and *Commissioner of Income Tax v. Hewlett Packard*

21 *(2020) 427 ITR 319 (Madras)*

Global Soft Ltd[22], submitted that interest on loans provided to the employees is to be considered as integral part of the business of the entity and, hence, eligible to deduction under Section 10A/10B of the Act.

20.2. It is submitted that the scrap income relates to the undertaking, since it is derived from the scrap arising from eligible operations and, therefore, the same is eligible for the deduction under Section 10A of the Act.

20.3. On this issue, it is ultimately submitted that in respect of loan to employees and scrap sales, the immediate nexus is the business of the undertaking only and not an external source like interest on fixed deposit, as contended by the Revenue. The loan to employees was given in the ordinary course of the business of the undertaking and accordingly, the same is part of eligible profits in determining deduction under Section 10A of the Act. The decisions in *Commissioner of Income-tax v. Sankhya Technologies (P) Ltd* (supra), after considering the Full Bench decision in *Commissioner*

22 *(2018) 403 ITR 453 (Karnataka)*

of Income Tax v. Hewlett Packard Global Soft Ltd (supra), expound the said proposition.

21.1. In reply, learned Standing Counsel submitted that Section 10A of the Act grants deduction against income tax specifically on income derived from export of articles or things or computer software which results in earning of foreign exchange for India. Admittedly, the miscellaneous income that is earned by the assessee is neither from export of any articles or things or computer software, nor it has been earned in foreign exchange, which are the pivotal requirements to claim deduction under Section 10A of the Act.

21.2. To shore up the said submission, reliance is placed on the following decisions:

i. *India Comnet International v. ITO*[23];

ii. *CIT v. Menon Impex (P) Ltd*[24]; and

iii. *CIT v. Sterling Foods*[25].

23 *(2012) 26 taxmann.com 349 (SC)*
24 *(2003) 259 ITR 403 (Madras)*
25 *(1999) 237 ITR 579 (SC)*

22.1. On the issue as to whether the assessee, who earned miscellaneous income in the nature of interest on loan given to employees and sale of scrap, is entitled to claim deduction under Section 10A/10B of the Act, the Assessing Officer denied the claim by stating that miscellaneous income does not have direct nexus with the business of the eligible undertaking. It is the case of the assessee that though the issue was upheld by the CIT(A), it was not adjudicated by the ITAT in the impugned order, though a specific ground was raised.

22.2. On this issue, we may profitably refer to two decisions in *Commissioner of Income-tax v. Sankhya Technologies (P) Ltd (supra)* and *Commissioner of Income Tax v. Hewlett Packard Global Soft Ltd (supra),* which, in our view, conclude the issue in favour of the assessee.

22.3. In the case of *Commissioner of Income-tax v. Sankhya Technologies (P) Ltd* (supra), it was held by this court as below:

"5. It has been brought to the notice of this Court that there is a judgment of the Full Bench of the Karnataka High Court, to which one of us (Dr. Vineet Kothari, J.) was a party, in which the Full Bench has held that the interest on bank deposits is also eligible to be included in the profits of 100% Export Oriented Units for the purpose of claiming deduction under Section 10A/10B of the Income Tax Act. The relevant portion of the judgment of the Full Bench of the Karnataka High Court is quoted below.

> *"35. The Scheme of Deductions under Chapter VIA in Sections 80-HH, 80-HHC, 80-IB, etc. from the 'Gross Total Income of the Undertaking', which may arise from different specified activities in these provisions and other incomes may exclude interest income from the ambit of Deductions under these provisions, but exemption under Section 10-A and 10-B of the Act encompasses the entire income derived from the business of export of such eligible Undertakings including interest income derived from the temporary parking of funds by such Undertakings in Banks or even Staff loans. The dedicated nature of business or their special geographical locations in STPI or SEZs. etc. makes them a special category of assessees entitled to the incentive in the form of 100%*

Deduction under Section 10-A or 10-B of the Act, rather than it being a special character of income entitled to Deduction from Gross Total Income under Chapter VIA under Section 80-HH, etc. The computation of income entitled to exemption under Section 10-A or 10-B of the Act is done at the prior stage of computation of Income from Profits and Gains of Business as per Sections 28 to 44 under Part-D of Chapter IV before 'Gross Total Income' as defined under Section 80-B(5) is computed and after which the consideration of various Deductions under Chapter VI-A in Section 80HH etc. comes into picture. Therefore analogy of Chapter VI Deductions cannot be telescoped or imported in Section 10-A or 10-B of the Act. The words 'derived by an Undertaking' in Section 10-A or 10-B are different from 'derived from' employed in Section 80-HH etc. Therefore all Profits and Gains of the Undertaking including the incidental income by way of interest on Bank Deposits or Staff loans would be entitled to 100% exemption or deduction under Section 10-A and 10-B of the Act. Such interest income arises in the ordinary course of export business of the Undertaking even though not as a direct result of export but from the Bank Deposits etc., and is therefore eligible for 100% deduction.

36. We have to take a purposive interpretation of the Scheme of the Act for the exemption under Section 10-A/10-B of the Act and for the object of granting such incentive to the special class of assessees selected by the Parliament, the play-in-the-joints is allowed to the Legislature and the liberal interpretation of the exemption provisions to make a purposive interpretation, was also propounded by Hon'ble Supreme Court in the following cases:—

"I] In Bajaj Tempo Ltd., Bombay v. Commissioner of Income Tax, Bombay, [(1992) 3 SCC 78], the Hon'ble Supreme Court held that:- "5. … ..Since a provision intended for promoting economic growth has to be interpreted liberally, the restriction on it, too, has to be construed so as to advance the objective of the section and not to frustrate it. But that turned out to be the, unintended, consequence of construing the clause literally, as was done by the High Court for which it cannot be blamed, as the provision is susceptible of such construction if the purpose behind its enactment, the objective it sought to achieve and the mischief it intended to control is lost sight of. One way of reading it is that the clause

excludes any undertaking formed by transfer to it of any building, plant or machinery used previously in any other business. No objection could have been taken to such reading but when the result of reading in such plain and simple manner is analysed then it appears that literal construction would not be proper. …"

II] In R.K. Garg v. Union of India, [(1981) 4 SCC 675] = [1982 SCC (Tax) 30 p.690], the Hon'ble Apex Court has held as under : - "8. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J., that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human

rights are involved. Nowhere has this admonition been more felicitously expressed than in Morey v. Doud [351 US 457 (1957) : 1 L.Ed.2d 1485 (1957)] where Frankfurter, J., said in his inimitable style:"In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events — self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability." The Court must always remember that "legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry"; "that exact wisdom and nice adaption of remedy are not always possible" and that "judgment is largely a prophecy based on meagre and uninterpreted experience". Every

legislation particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid."

37. On the above legal position discussed by us, we are of the opinion that the Respondent assessee was entitled to 100% exemption or deduction under Section 10-A of the Act in respect of the interest income earned by it on the deposits made by it with the Banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as 'Income from other Sources' under Section 56 of the Act. The incidental activity of parking of Surplus Funds with the Banks or advancing of staff loans by such special category of assessees covered under Section 10-A or 10-B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its

profits and gains derived by the Undertaking engaged in the export of Articles as envisaged under Section 10-A or Section 10-B of the Act and cannot be taxed separately under Section 56 of the Act.

38. We therefore affirm and agree with the view expressed by the first Division Bench of this Court in the case of Motorola India Electronics (P) Ltd. (supra) and we do not agree with the view taken by the subsequent Division Bench on 10/04/2014 in the present case.

39. Both the questions thus framed above are answered in favour of the Respondent Assessee and against the Revenue in the terms indicated above and the matter is sent back to the Division Bench for deciding this Appeal in accordance with the aforesaid opinion."

22.4. Therefore, all profits and gains of the undertaking, including the incidental income by way of interest on bank deposits or staff loans, would be entitled to 100% exemption or deduction under Section 10A/10B of the Act, as such interest income arises in the ordinary course of export business of the undertaking, even

though not as a direct result of export.

22.5. In the other decision in *Commissioner of Income Tax v. Hewlett Packard Global Soft Ltd* (supra) also, similar view was taken by a Full Bench of the Karnataka High Court. The relevant portion of the said decision is reproduced hereunder:

> *"37. On the above legal position discussed by us, we are of the opinion that the respondent-assessee was entitled to 100 per cent. exemption or deduction under section 10A of the Act in respect of the interest income earned by it on the deposits made by it with the banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as "income from other sources" under section 56 of the Act. The incidental activity of parking of surplus funds with the banks or advancing of staff loans by such special category of assessees covered under section 10A or 10B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its profits and gains derived by the undertaking engaged in the export of articles as envisaged under section 10A or section 10B of the Act and cannot be taxed separately under section 56 of the Act."*

22.6. Reliance on the decisions in the cases of *India Comnet International v. ITO (supra)*; *CIT v. Menon Impex (P) Ltd (supra)*; and *CIT v. Sterling Foods (supra)* by the revenue is misplaced on facts.

22.7. In *India Comnet International v. ITO (supra),* the Supreme Court considered the decision of the Madras High Court in *CIT v. Menon Impex (P) Ltd (supra),* where the nature of interest income derived by the assessee was from funds in connection with Letter of Credit. The Supreme Court decision turned more in respect of the claim of deduction on the interest income on foreign currency deposit account. Therefore, the said decisions do not come to the aid of the revenue, as the nature of deposits were not in the nature of interest earned on loans advanced to the employees and sale of scrap, which were in the ordinary course of business of the undertaking.

23. Accordingly, this question of law is also decided in favour

of the assessee and against the revenue.

SUBSTANTIAL QUESTION OF LAW IN T.C.A.No.279 of 2016:

24. This issue is with respect to the finding of the ITAT that the assessee is liable to pay interest under Section 234D of the Act on the excess refund paid.

25. Learned counsel for the assessee, in fairness, submits that, by virtue of an amendment made vide Finance Act, 2012 with retrospective effect from 01.06.2003 in Explanation 2 to Section 234D of the Act, which provides that the provisions of Section 234D of the Act apply even for assessment year 2003-2004 and prior years, provided the assessment proceedings of that year is completed after 01.06.2003, and since the assessment order in this case was passed on 28.02.2006, the question of law is to be decided against the assessee.

26. In view of the aforesaid submission made by learned

counsel for the assessee, the view taken by the ITAT that the appellant is liable to pay interest under Section 234D of the Act on the excess refund paid is in accordance with law.

27. Accordingly, this question of law is answered against the assessee and in favour of the revenue.

28. To sum up, the substantial questions of law raised in TCA Nos.277, 278 and 280 of 2016 are answered in favour of the assessee and against the revenue and the substantial question of law raised in TCA No.279 of 2016 is answered in favour of the revenue and against the assessee.

Resultantly, TCA Nos.277, 278 and 280 of 2016 are allowed and TCA No.279 of 2016 is dismissed. There shall be no order as to costs.

(MANINDRA MOHAN SHRIVASTAVA, CJ) (SUNDER MOHAN,J)
25.11.2025

Index : Yes

Neutral Citation : Yes

sasi

To:

1. The Assistant Registrar
   Income Tax Appellate Tribunal
   Madras.

2. The Commissioner of Income Tax (Appeals)-III
   Chennai – 600 034.

3. The Assistant Commissioner of Income Tax
   Company Cirlce-I(3), Chennai.

THE HON'BLE CHIEF JUSTICE
AND
SUNDER MOHAN,J.

(sasi)

TCA Nos.277 to 280 of 2016

25.11.2025