Standard Chartered Bank Vs. Inspecting Assistant

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Dec-13-1990

Reported in : (1991)39ITD57(Mum.)

Judge : M Ajinkya, G Israni

Appellant : Standard Chartered Bank

Respondent : inspecting Assistant

Judgement :

1. to 8. [These paras are not reproduced here as they involved minor issues.] 9. The next two grounds (9 and 10 for the assessment year 1985-86, 8 and 9 for the assessment year 1986-87) raise an interesting question of law. The case of the assessee is that the CIT(A) erred in holding that the assessee's claim of deduction of Rs. 37,82,630 for the assessment year 1985-86 and Rs. 60,14,906 for the assessment year 1986-87 towards provision for the debts under the amended Section 36(1)(viia) is not sustainable in the law under the non-discrimination clause provided in the Avoidance of Double Taxation Agreement entered into between the Government of the India and the United Kingdom. The relevant facts in this regard may be stated. The assessee claimed that the provision for bad debts amounting to Rs. 37,82,613 made during the year was deductible under the new Section 36(1)(viia) introduced with effect from 1-4-1985. Although this section is not applicable to the assessee bank having been incorporated outside India, it was, according to the assessee, applicable under the non-discrimination clause included in the Avoidance of Double Taxation Agreement entered into between the

Governments of U.K. and India. The IAC rejected this claim on the ground that there was nothing in the Avoidance of Double Taxable Agreement which was contrary to the provisions of Section 36(1)(viia) and, therefore, the assessee could not claim relief under this section.

According to the IAC, the assessee cannot be treated as a national being a corporate entity and the provisions of this section which were extended to the assessee bank with effect from 1-4-1987, cannot be made applicable to the assessee for the assessment year 1985-86.

9.1 The CIT(A) has extensively dealt with this issue in para 12 of his order. Before the CIT(A), the assessee placed reliance on the circular of the CBDT issued under Circular No. 333 under Board F.No.506/42/81-FTD dated 2-4-1982. This circular provided that when the Double Taxation Avoidance Agreement provides a particular mode of computation, the same shall be followed irrespective of the provisions of the IT Act, and where there is no specific provision in the Double Taxation Avoidance Agreement, the provisions of the Income-tax Act shall govern the taxation of income. After considering this argument, the CIT(A) held after careful study of the provisions of Section 36(1)(viia) that this section was inserted with the objective of providing cushion to the rural banks under which an amount not exceeding one-half of the aggregate average advance made by the rural branches of a scheduled and non-scheduled bank was allowed as a deduction. The provisions of Section 36(1)(viia) were amended by Finance Act, 1985 with effect from 1-4-1985 to extend the cushion to all scheduled and non-scheduled banks and an amount not exceeding 10% of the total income of an amount not exceeding 2% of the aggregate average advance made by the rural branches of such bank whichever is higher was allowed as a deduction to the concerned banks. The CIT(A) held that the assessee company did not deserve to succeed in its claim under Section 36(1)(viia) of the IT Act and the reasons given by the CIT(A) were basically as follows : The provisions contained in Section 36(1)(viia) of the Act applicable to Indian Banks (prior to 1-4-1987) were entirely keeping in view of the fact that Indian banks were operating in rural sectors of India through its rural branches and were functioning under social obligation of uplift and development of rural sectors in India and in doing so had been making advances to poorer sections of society in rural India, many a time without adequate security etc. and were thus burdened with attendant hazards in matters of recovery. As against this the foreign banks operating in India are having their branches only in prime urban area of India and therefore the legislature had not thought it fit to extend the benefit of Section 36(1)(viia)of the IT Act to Non-Resident Banks, prior to 1-4-1987. The non-discrimination clause contained in Article 23 of the Avoidance of Double Taxation Agreement between India & U.K. is of no help to the appellant company as the non discrimination clause prohibits discrimination "in the same circumstances or under the same conditions" and there would hardly be a dispute on the point that the Indian banks operating in rural India and the Non-Resident banks operating in prime urban area of India were not functioning in the same circumstances or under the same conditions. In fact the apprehension of discrimination in the minds of the appellant company, in my view is not well founded and is not sustainable in law.

These observations are strenuously challenged by the assessee in the last two grounds for both these years.

9.2 Shri Dastur first referred us to Circular No. 333 dated 2-4-1982 (page 100 of the compilation) where, inter alia, it was stated as under :- 2. The correct legal position is that where a specific provision is made in the double taxation avoidance agreement, that provision will prevail over the general provisions contained in the Income-tax Act.

In fact 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 country 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 of the Income-tax Act.

Where there is no specific provision in the agreement, it is the basic law, i.e., the Income-tax Act, that will govern the taxation of income.

Shri Dastur then referred to the relevant article (viz. Article 23) of the Convention of Avoidance of Taxation and Prevention of Fiscal Evasion with Great Britain and Northern Island. Article 23 of this Convention reads as under: Article 23 - Non-discrimination-I. The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances are or may be subjected.

2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting Slate shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances or under the same conditions. This provision shall not be construed as preventing a Contracting State from charging the profits of a permanent establishment which an enterprise of the other Contracting State has in the first-mentioned State at a rate of tax which is higher than that imposed on the profits of a similar enterprise of the first-mentioned Contracting State, nor as being in conflict with the provisions of paragraph 4 of Article 7 of this Convention.

3. Nothing contained in this Article shall be construed as obliging a Contracting State to grant to individual not resident in that State any personal allowances, reliefs and reductions for taxation purposes which are by law available only to individuals who are so resident.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.

5. In this Article, the term "taxation" means taxes which are the subject of this Convention.

After referring to the above Article, Shri Dastur pointed out that the assessee was a national of the U.K. because it had its head office in the U.K. and not in India. There was no definition of the term "national" in this Agreement and, therefore, one had to turn to the decision of the Supreme Court in the case of State Trading Corpn. of India Ltd. v. CTO AIR 1963 SC 1811. In this case, the Supreme Court observed that the Corporation may have nationality in accordance with the country of their incorporation but that does not necessarily confer citizenship on them. At para 18 of the judgment (page 1819). Their Lordships observed that a Corporation incorporated in England has a British nationality, irrespective of the nationality of its members, and proceed to distinguish the difference between the concept of 'nationality' and 'citizenship' in the following words : But the question still remains whether "nationality" and "Citizenship" are interchangeable terms. "Nationality" has reference to the jural relationship which may arise for consideration under international law. On the other hand "citizenship" has reference to the jural relationship under municipal law. In other words, nationality determines the civil rights of a person, natural or artificial, particularly with reference to international law, whereas citizenship is intimately connected with civic rights under municipal law. Hence all citizens are national of a particular Suite but all nationals may not be citizens of the State. In other words citizens are those persons who have full political rights as distinguished from nationals who may not enjoy full political rights and are still domiciled in that country (vide P. Weis - Nationality and Statelessness in International Law pp. 4-6; and Oppenheim's International Law Vol. 1 pp. 642-644).

On the basis of these observations of the Supreme Court, Shri Dastur argued that the assessee was a national of the U.K. and, in terms of Article 23, could not be subjected in other Contracting State, i.e. in India, to any taxation which is more burdensome than the taxation to which nationals of India in the same circumstances are or may be subjected. According to Shri Dastur, this respect of the matter was not properly appreciated by the CIT(A). Shri Dastur then referred to the legislative history of Clause (viia) of Section 36 (page 287) of Kanga &

Palkhivala on Income-tax - 8th Edition) and argued that the Government itself had realized the discrimination that was between the Indian banks and the foreign banks in the matter of allowing deduction for bad and doubtful debts made by a scheduled bank in relation to advances made by rural branches. Shri Daslur pointed out that the CIT(A) accepted that the argument that in view of the non-discrimination clause contained in Article 23 of the Avoidance of Double Taxation Agreement between India and U.K., the U.K. Bank operating in India could not be less favourably treated than an Indian Bank, was well taken being correct in law; but the CIT(Appeals) declined to allow the assessee's claim for deduction under Section 36(1)(viia) merely because of the wording of the section as it stood prior to 1-4-1987. According to Shri Dastur, the amendment brought about from 1-4-1987. Only proved that the Government had realised that there was unfair discrimination between scheduled banks and foreign banks.

10. We have considered carefully the various arguments advanced by Shri Dastur and by the learned Departmental Representative and have carefully gone through the order of the CIT(A) as well as the DTA Agreement. Section 36(1)(viia) as it stood for the relevant assessment years read as under :- (viia) in respect of any provision for bad and doubtful debts made by a scheduled bank (not being a bank approved by the Central Government for the purposes of Clause (viia) or a bank incorporated by or under the laws of a country outside India) or a non-scheduled bank, an amount not exceeding ten per cent of the total income (computed before making any deduction under this clause and Chapter VI-A) or an amount not exceeding two per cent of the aggregate average advances made by the rural branches of such bank, computed in the prescribed manner, whichever is higher.

(i) "non-scheduled bank" means a banking company as defined in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949), which is not a scheduled bank; (ia) "rural branch" means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; This section provided for deduction of an amount not exceeding 10 per cent of the total income or an amount not exceeding 2 per cent of the aggregate average advances made by the rural branches as deduction in respect of any provision for bad and doubtful debts made by a scheduled bank. The section as it then stood did not apply to a bank incorporated by or under the laws of a country outside India. However, the section was substituted by the Income-tax (Amendment) Act 1986 with effect from 1-4-1987 and the amended section in terms of an additional clause, namely Clause (b), provided that in the case of a bank, being a bank incorporated by or under the laws of a country outside India, and amount not exceeding five per cent of the total income was to be given as a deduction in respect of provision for bad and doubtful debts. By the same Amendment, in respect of scheduled banks incorporated in India, the extent of the deduction was reduced from an amount not exceeding 10 per cent of the total income to an amount not exceeding 5 per cent of the total income. Prima facie, it would appear that prior to the amendment brought about with effect from 1-4-87 in this section, the benefit of deduction on account of provision for bad and doubtful debts would not be available to banks incorporated by or under laws of a country outside India. We have, therefore, to see whether in the present case the benefit conferred by Article 23 of the Double Taxation Avoidance Agreement between India and the U.K. would be available to the assessee herein which is a bank incorporated in the U.K. and which has claimed deduction on account of provision for bad and doubtful debts under the non-discrimination clause of this Agreement and which deduction denied to it by the IAC and the CIT(Appeals) on the ground that the Section 36(1)(viia) as it then stood at the relevant time specifically excluded banks incorporated outside the country from its operation. Here, it would not be out of place to consider the scope and effect of Clause (viia) to Section 36(1) which was first inserted by Finance Act 1979 with effect from 1 -4-80. Under Section 36(1)(vii) of the Act, any taxpayer carrying on business or profession is entitled to a deduction in the computation of its taxable income the amount of any debt which is established to have become bad provided certain conditions arc fulfilled. However, a mere provision for bad and doubtful debts is normally not allowed as a deduction in the computation of taxable profits. Now, in order to promote rural banking and assisting the scheduled commercial banks in making proper provisions from their current profits to provide for risks in relation to their rural advances, the Finance Act 1979 inserted a new Clause (viia) in Sub-section (1) of Section 36 to provide for a deduction in computation of taxable profits in all scheduled commercial banks in respect of provisions made by them for bad and doubtful debts relating to advances made by their rural branches. Apparently, all co-operative banks as well as banks incorporated by or under the laws of a country outside India were excluded from the purview of this provision. Now, Article 23 of the DTA Agreement between India and the U.K. specifically provides that the nationals of a Contracting State shall not be subjected to the other Contracting State to any taxation or requirement connected therewith which is either more burdensome than the taxation and connected requirements to which nationals of that other State may be subjected. The CIT(A) has not considered the effect of the term "nationals of a Contracting State". As observed by the Supreme Court in Slate Trading Corpn. Ltd.'s case (supra), the Corporation have nationality in accordance with the country of their incorporation. The Supreme Court specifically distinguished between 'nationality' and 'citizenship' and stated that nationality has reference to the rural relationship which may arise for consideration under international law.

The assessee herein being incorporated in India is a national of one of the Contracting States, namely, the U.K. Since our country has a DTA Agreement with the U.K., any national of that State cannot be subjected to a higher burden of tax than a national of the Indian State. Now, a scheduled commercial bank in India in that sense is a national of India being incorporated in India and cannot claim a benefit under the tax laws under a section which specifically denies such benefit to the national of the U.K. This is so because of Article 23 of the DTA Agreement. CIT(A)'s argument firstly is that Clause (b) to Section 36(1)(viia), which is applicable to non-resident banks, becomes operative for and from the assessment year 1987-88. The second argument of the CIT(A) is that the assessee being a non-resident bank would only be functioning in prime urban area and would not be having rural branches and, therefore, could not be said to be carrying on the same activity in the same circumstances or under the same conditions.

According to the CIT(A), the provisions of Section 36(1)(viia), as they stood prior to 1-4-87, were mainly applicable to Indian Banks operating in rural sectors of India through its rural branches. As against this, the foreign banks operating in India have their branches only in prime urban areas and, therefore, the legislature did not think it fit to extend the benefit of Section 36(1)(viia) to non-resident banks.

Although, prima fade, there is substance in what the CIT(A) has to say in this regard, the CIT(A) has not, in our opinion, considered the effect of the term 'national of a State', an aspect which is already discussed a little earlier in the order. Secondly, the assumption of the CIT(A) that the benefit of Section 36(1)(viia) was not intended to be given to foreign banks because they were not expected to have branches in rural areas is belied by the Government itself which has extended the benefit of this section to such banks by introduction of Clause (b) with effect from 1-4-87. Therefore, we cannot proceed on the assumption that this section was exclusively intended for considering advances effected by the scheduled banks to its rural branches. In that sense, the discrimination existing between Indian banks and foreign banks in respect of allowing deductions in this section on account of provision for bad and doubtful debts has been recognized by the Government, and by introducing Clause (b) to Section 36(1)(vii) it has only sought to remove such discrimination. If this much is clear i.e., there was a discrimination between the scheduled bank and foreign bank in the matter of deduction under this section prior to 1-4-87, then by virtue of Article 23 of the DTA Agreement, the assessee which is a bank incorporated in the U.K. and therefore a national of one of the Contracting States cannot be subjected to a higher burden of tax by being denied a claim for deduction which was available to Indian banks.

Now, it is well settled that a provision of a Double Taxation Avoidance Agreement will prevail over the general provisions contained in the Income-tax Act. The Board has laid down these principles specifically in their circular dated 2-4-82 referred to above and as pointed out by the learned counsel for the assessee, the Andhra Pradesh High Court in CIT v. Visakhapatnam Port Trust [1983] 144 ITR 146, has observed that this circular should be given effect to by the tax authorities. It is, therefore, not correct to say, as observed by the CIT(A), that the apprehension of discrimination in the mind of the company is not well founded. Such discrimination did exist in the section as it stood prior to the amendment and this fact was recognised by the authorities concerned when they amended the section by introducing Clause (b) with effect from 1 -4-87. Therefore, the deduction in respect of provision for bad and doubtful debts claimed under Section 36(1)(viia) would, in our opinion, be available to the assessee-company by virtue of operation of Article 23 of the DTA Agreement for reasons stated by us hereinabove. We direct accordingly. Ground Nos. 9 and 10 for the assessment year 1985-86 and 8 and 9 for the assessment year 1986-87 would therefore be treated as allowed.

11. to 23. [These paras are not reproduced here ax they involved minor issues.].