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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Jul-14-2005

Reported in : (2006)99TTJ(Delhi)880

Judge : N Vasudevan, K Ranjan

Appellant : Pride Foramer S.A. (Formerly

Respondent : Acit, Spl. Range

Judgement :

1. This appeal by assessee for assessment year 1998-99 arises out of order of CIT(A)-I, Dehradun passed under Section 201(1) of the Act. In ground No. 1 to 5 the assessee's grievance is that no tax was payable on remuneration of expatriates who fulfilled all the conditions of exemption in terms of Article XIV(2) of Double Taxation Avoidance Agreement with France.

2. The assessee is a Non-resident company incorporated in France.

During the financial year 1987-88 relevant to assessment year 1988-89, the assessee company had executed three contracts with ONGC. The first was of Drilling operations on assessee's own rig I.D.A. The others were manning and management services contracts for supervision of drilling activities carried on by ONGC on its own rigs namely (a)Sagar Vijay and (b) Sagar Bhushan. For the purpose of executing these contracts, the assessee engaged the services of number of technicians. In respect of expatriates deputed for business operations

on Jack up rig I.D.A. owned by the assessee, tax was duly deducted at source under the Income Tax Act from the salary paid, as the proceeds of contracts were business profit receipts. Salary paid to expatriate employees was claimed as deductible expenditure. In case of manning and management contracts for services rendered on ONGC rigs Sagar Vijay and Sagar Bhushan in respect of expatriates whose stay in India did not exceed 183 days during the previous year, no tax was deductible on the ground that the salaries paid to such expatriates was exempt under Article XIV(2) of DTAA. It was also claimed that income from manning and management contracts was taxable as technical fees as per Article XVI and not as business profits under Article III of DTAA. The assessing officer rejected the contention of the assessee that income of assessee was taxed Under Section 44BB and therefore benefit of provisions of Article XIV(2) of DTAA was not available. The assessee was held as an assessee in default under Section 201(1) of the Act. The assessee was also liable to deduct tax in respect of off period salary on the ground that the same was in nature of salary paid for earned leave period. Also the assessee was held liable to deduct tax at source on perquisite value of free boarding and lodging facilities provided to expatriate technicians by the employer.

3. On appeal, the Id. CIT(A) observed that the assessee had a permanent establishment in India and it cannot be denied that salaries for the projects executed in India were borne out by permanent establishment in India. In fact, the expenses of permanent establishment in India was never in dispute earlier because the appellant had filed return of loss on the basis of profit and loss account submitted and they have claimed vide note No. 2 and 3 of statement of income that provisions of Article III were applicable and so tax can be charged only on the basis of net income earned through permanent establishment. The mere fact that no salaries have been debited in the profit and loss account pertaining to the Indian operations will not make a difference. The DTAA clearly provides that where an enterprise of one contracting state carries on business in the other contracting state through a permanent establishment therein, there shall in each contracting state be attributed to that permanent establishment the profits it might be expected to make as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and

dealing wholly independently with the enterprises of which it is a permanent establishment. This clearly means that irrespective of the fact that whether the salary is debited in the profit and loss a/c or not it shall be deemed to be attributed to the permanent establishment to calculate its profits under DTAA. He, therefore, held that by simply not debiting the salary to the P & L a/c pertaining to Indian operations will not absolved the assessee from deducting tax at source. The assessee's ground that salary was not taxable as the corporate assessment in earlier years were made Under Section 44D do not hold good As such since the assessee do not satisfy all the conditions laid down in the Article XIV (2) of DTAA, the assessing officer was held to justified in treating the assessee in default Under Section 201(1) of the Act.

3.1. Ld CIT(A) further observed that in the profit and loss account the assessee claimed expenses of Rs. 66,86,364/- and the amount of salary worked out on the basis of details made available are at Rs. 47,60,458/-. Thus, the total expenses works out to Rs. 1,14,46,822/- as against the gross contract receipt of Rs. 4,47,63,046/-. The expenditure on percentage of gross receipt thus worked out to 25.57%..

The Assessing Officer in order under Section 195(2) has allowed 30% of contractual receipt as expenditure before applying provisions of Section 44D read with Section 115A and Article III/XVI of DTAA. He, therefore, came to the conclusion that the Assessing Officer while allowing 30% expenses at the time of passing order under Section 195(2) has considered the salaries on ad hoc basis. Therefore, the assessee cannot fall back and say that there was no liability for tax deduction at source under Section 192 read with Section 195A of the Act.

3.2 Regarding applicability of decisions of ITAT in cases of Soulier Jeans, Boudier Christian and others in which department's application Under Section 256(2) was rejected, Ld CIT(A) observed that in these cases it has been held that if the income is offered for taxation as income from "fee for technical services" reference to Article III of DTAA was not at all attracted and all the conditions laid down in Article XIV(2) are satisfied, the salaries earn exemption. The assessee filed return of income on net income basis and the income was assessed as business income

Under Section 44BB. The return of income was not filed Under Section 44D. He further observed that the assessee applied and obtained exemption Under Section 10(6)(vii a) from the Ministry of Petroleum in the cases of most of the employees which is evident from the calculation made by AO for calculating the amount in default. He therefore came to the conclusion that the assessee was aware of the fact that the employees salary was taxable in India yet it did not deduct tax Under Section 192 by claiming exemption under DTAA which was not correct.

4. Ld AR of the assessee submitted that in case of all personnel whose stay in India was for a period of less than 183 days in the previous year, claim for non-taxability of remuneration was made during the course of proceedings Under Section 201 with reference to Article XIV (2) of DTAA with France. In case of Boudier Cristian and others ITAT Delhi Bench 'D' 46 ITD 114, held that fee for technical services were exempt from tax in terms of article XVI of the said agreement. This decision was followed by ITAT in the case of Jean Soulier and others for assessment years 1984-85, 1985-86 and 1986-87. In the case of Boudier Christian and Ors reference application under Section 256(1) was rejected by I.T.A.T. and by Allahabad High Court under Section 256(2) on technical grounds. He also submitted that reassessment proceedings initiated by the Department for assessment years 1989-90 and 1990-91 to assess technical services as business profits under Section 44BB has been quashed by jurisdictional High Court.

4.1 It is further submitted that prior to Scan Drill case decided by I.T.A.T. and the instructions No. 1862 dated 22.10.1990 issued by the CBDT in spite of insertion of Section 44BB, the proceeds of Manning and Management contract were subjected to tax as 'fee for technical services' in terms of Article XVI of DTAA with France. The proceeds were taken on net income basis with expenses limited to actually incurred in India. For the assessment year 1988-89 under consideration, the return of income was filed by the assessee claiming expenses incurred in India without deducting the claim in respect of salaries of personnel which was paid by Head Office. However, the assessment was made by the Department under Section 44BB taking the presumptive net profit of 10% of gross receipts from 'manning and management' contracts instead of 'fee for technical services'. The Assessing

Officer while doing so has followed CBDT instruction as well as the decision of I.T.A.T. in the case of Scan Drill. According to assessing officer, the balance 90% of the amount representing expenditure will include the salary of the expatriates and thus deemed to have been deducted in computing the income of the company.

4.2 The Id. A.R. of the assessee submitted that the taxability of employer on presumptive basis under Section 44BB does not lead to any legal presumption that salary was deducted in computing the profits of the employer in India when, in fact, no salary was actually deducted.

Section 44BB has a non obstante clause and has limited application with one deemed fiction of presumptive net profit of 10% of gross proceeds; no further deeming fiction can be introduced for interpretation of Article XIV(2) of DTAA. It is further submitted that there cannot be any estoppel against the statutory provisions and the agreed assessment is without any meaning when Tax Department was merely following instruction of CBDT and applying the provisions of Section 44BB read with Section 90(2) of I.T. Act, 1961. No salary was actually deducted in the audited accounts in India in computing the chargeable profit nor can be deemed to be deducted with reference to decision of Hon'ble Supreme Court in the case of Tirunelveli Motor Works Service Company Pvt. Ltd. v. CIT 78 ITR 56 (S.C.) and the decision of Allahabad High Court in the case of Karamat Khan v. CIT U.P. 48 ITR 642(A11.).

4.3 It is further submitted that Hon'ble Supreme Court in the case of Berger Paints India Ltd. v. CIT 266 ITR 99 has held that if the Department has not challenged the correctness of a decision, it is not open to the Department in the case in other cases without any just cause. It applies more so when the jurisdictional High Court in appellant's own personnel cases has upheld the applicability of Article XIV (2) by holding the non-taxability of salary which has been accepted by the Income Tax Department.

4.4 Further, referring to provisions of Section 44AD, the Id. A.R. of the assessee submitted that in case of contractors where books of accounts are not maintained, the profit is determined @ 8% of gross receipts. Sub-section (2) of Section 44AD

provides that any deduction allowable under Section 30 to 38 shall be deemed to have been given full effect to and no further deduction under those sections shall be allowed. The provisions of similar nature are not available in Section 44BB and, therefore, it cannot be said that while computing the income @ 10% of the gross receipts deduction under Sections 30 to 38 has been allowed.

4.5 On the basis of these submissions, it has been submitted that the salary paid to expatriates was in the nature of fee for technical services and the assessee has not claimed as deduction in computing the income in India and, thus the provisions of Article XIV(2) of DTAA are satisfied. Therefore the 'fee for technical services' being non taxable, the assessee was not liable to deduct tax at source.

5. The Id. D.R. on the other hand submitted that assessee's income has been assessed under Section 44BB of the Act. Therefore the amount of salary is included in 90% of expenses allowed under Section 44BB of the Act. Consequently the third condition of paragraph (2) of Article XIV is not satisfied making the payment of fee for technical services as taxable in India. The Assessing Officer has rightly held that the assessee was liable to deduct tax at source on salary paid by the assessee to the expatriate technicians. As regards reliance placed by the assessee on the decision of jurisdictional High Court and Hon'ble Supreme Court it has been submitted that the said decisions relate to reopening of assessment under Section 147 and no decision on the taxability of salary has been rendered by Allahabad High Court and the Apex Court, therefore, the decisions relied upon by the Id. A.R. are not relevant.

6. We have heard both the parties. There is no dispute that assessee had permanent establishment in India. The assessee has accepted that the income from manning and management services is to be assessed as business income. For assessment year 1988-89 the Assessing Officer has assessed the income under Section 44BB of the Act. No appeal against the order assessing receipts under Section 44BB was filed. In case of Boudier Christian and others & Jean Soulier and Others in assessment year 1984-85, 1985-86 and 1986-87, assessee's receipts were assessed as 'fee for technical services' under Section 44D of the Act The facts of the case for the year under consideration being

distinguishable the decision of IT AT in the case of Boudier Christian and others & Jean Soulier and Others in assessment year 1984-85, 1985-86 and 1986-87 cannot be applied. However the assessee has submitted that there cannot be any estoppel against the statutory provisions in a case where an agreed assessment is made by merely following instruction of CBDT and applying the provisions of Section 44BB read with Section 90(2) of I.T.Act, 1961. In order to examine this issue a reference is to be made to Article XIV and XVI of DTAA. Article XIV of DTAA between India France, is relevant for determination of the issue involved in the appeal and is reproduced as under: "(1) Article XIV(l): Subject to the provisions of Article XII salaries, wages or other similar remuneration for services as an employee performed in one of the contracting states by an individual who is a resident of the other contracting state may be taxed only in the contracting state in which such services are rendered.

(2) Notwithstanding the provisions of paragraph (1) of this Article, salaries, wages or other similar remuneration paid to an individual who is a resident of one of the contracting states for services performed in that other contracting in states shall not be subjected to tax in that other contracting states and may be subjected to tax in the former contracting state, if, (a) he is present in that contracting state for a period or periods not exceeding in aggregate 183 days in the taxable year concerned, and (b) the remuneration is paid by or on behalf of an employer who is not a resident of that other contracting state and (c) the remuneration is not deducted in computing the profits of a permanent establishment chargeable to tax in that other contracting state." 6.1 This tribunal in ITA No. 7488/Del/89 for assessment year 1985-86 in the case of Sh. Machin Roy have drawn a distinction between the foreign employer not having a permanent establishment in India being liable to tax by virtue of Article XIV of DTAA and a business enterprises having a permanent place of business in India. Whereas in the case of persons carrying on a trade or industrial activities having permanent establishment in India would fall under condition (c) of Article XIV(2). There is no dispute that during the year under consideration the assessee had permanent establishment in India. As such condition (c) would be applicable. There is no dispute that the assessee agreed to be assessed under provisions of Section 44BB for manning and management services rendered by it.

6.2 The next issue to be decided is whether remuneration paid outside India by the assessee can be treated to have been deducted in computing the profit of permanent establishment chargeable to tax in India. The Assessing Officer in order under Section 195(2) has allowed 30% of contractual receipt as expenditure before applying provisions of Section 44D read with Section 115A and Article III/XVI of DTAA. The contention of the assessee that in computing profits in India, the salary of the expatriates has not been debited has no relevance, when income is computed in accordance with the provisions of Section 44BB. The contention of the assessee has relevance only when income is determined under other provisions of law. In the case of *Kedarnath Jute Manufacturing Co. Ltd. v. CIT* Hon'ble Supreme Court held that entries in the books of accounts are not in any way determinative of an item of income or expenditure. Whether an assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of accounts be decisive or conclusive in the matter. Respectfully following the decision of Hon'ble Supreme Court it is held that recording of payments on account of salaries paid to expatriate technicians for rendering services in India in the books of accounts of the Head Office outside India cannot be said that assessee had not incurred expenditure in India. Moreover debiting of expenditure relating to permanent establishment in India in head office accounts is a colourable device adopted by the assessee to avoid the payment of tax and as such is covered by the decision of Hon'ble Supreme Court in the case of *Mc Dowells & co. v. CTO* 154 ITR 148. Thus it is to be concluded that payment made to expatriate technicians on account of remuneration by the foreign employer having permanent establishment in India, irrespective of their stay India is liable to tax in India.

6.3 Now question arises whether 90% deduction allowed under deeming provisions of Section 44BB will include salary/remuneration paid to expatriates. The contention of the assessee is that deeming fiction for determination of income under Section 44BB cannot be applied for deeming expenditure on account of salaries and that too when a deeming provision for expenditure incurred similar to Section 44AD is not available under Section 44BB of the Act. Reliance has been placed on the decision of Hon'ble Supreme Court in the case of *Tirunelveli Motor*

Works Service Company Pvt. Ltd. v. CIT 78 ITR 56 (S.C.) and the decision of Allahabad High Court in the case of Karamat Khan v. CIT U.P. 48 ITR 642(All.). In the case of Tirunelveli Motor Works Service Company Pvt. Ltd. v. CIT 78 ITR 56 (S.C.) for assessment year 1950-51, the assessee company had returned its income after deducting Rs 71,947 towards the annual bonus payable to its employees but there was no evidence to show that while making the best assessment judgment the assessing officer had taken the liability to pay bonus into consideration and, in the assessment year 1957-58, only Rs 17,470/- were paid to employees, it was held that for assessment year 1957-58, Rs 54,479/- (i.e. the difference between Rs 71,949 and Rs 17,470) could not be assessed as the assessee's deemed profits under Section 10(2A). Facts of the case before us are different and distinguishable from the facts of the case decided by Hon'ble Supreme Court. It is a case where assessee had debited expenditure in head office accounts and not in the books maintained in India. The issue whether liability was incurred on account of salaries paid incurred in India or outside India has been decided in the immediate preceding paragraph 6.2. Now limited question to be decided is whether under deeming provisions of Section 44BB aimed to determine the income of the assessee would be capable of deeming expenditure also.

6.3.1 In interpreting a provision creating a legal fiction, the court is to ascertain for what purpose the fiction is created and after ascertaining this, the court is to assume all those facts and consequences which are incidental or inevitable corollaries to give effect to the fiction. In an oft-quoted passage, Lord Asquith in East End Dwelling Co. Ltd. Finsbury Borough Council (1951) 2 All ER 587,589(HL), observed: "If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequence and incident which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it.....the statute says that you must imagine a certain state of affairs. It does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs".

Thus if A is deemed to be B, compliance with A is in law compliance with B and contravention of A is in law contravention of B.6.3.2 In CIT v. Rampur Timber and Turnery Co. Ltd. , Hon'ble High Court observed that Section 41(1) deems the remitted amount of a trading liability to be profits and gains of business or profession and makes it chargeable to income-tax as business income of the year of remission. Thus, business itself is, by Section 41(1), deemed to have existed during the previous year concerned and the deemed business income should be available for set off of earlier unabsorbed depreciation.

6.3.3 Hon'ble Supreme Court in the case of CIT v. S. Teja Singh dealing with the Indian Income Tax Act, 1922, which by Section 18-A(3) required any person not hitherto assessed to send in certain circumstances an estimate of his income to the ITO for purposes of advance payment of tax and which by clause(9) provided that if during the course of regular assessment the ITO was satisfied that such person had without reasonable cause failed to comply with Clause (3) the assessee 'shall be deemed to have failed to furnish the return of his total income and the provisions of Section 28, so far as may be shall accordingly', the question was whether a penalty could be levied under Section 28 which provided for the levy of penalty when a person without reasonable cause failed to furnish a return of his total income after notices under Section 22(2) or Section 34 had been issued to him.

The Supreme Court answered the question in the affirmative and held that the failure to send the estimate under Clause (3) of Section 18A was by the fiction created by Clause (9) of the same Section deem to be a failure to send a return and consequently " all those facts on which alone there could be failure to send the return must be deemed to exist and it must accordingly be taken that by reason of this fiction notices required to be given under Section 22 must be deemed to have been given"; making Section 28 applicable.

6.3.4 Hon'ble Supreme Court in the case of CED v. Kantilal Tirkamal 105 ITR 92 observed that Explanation 2 of Section 2(15) of the Estate Duty Act, 1953 furnishes example of legal fiction which extends the normal meaning of a word. The explanation provides: "The extinguishment at the expense of the deceased of

debt or other rights shall be deemed to have been a disposition made by the deceased in favour of the person for whose benefit the debt or right was extinguished and in relation to such a disposition the expression 'property' shall include the benefit conferred by the extinguishment of a debt or right". In view of this explanation it has been held that when the deceased, who was a coparcener in a Hindu Joint Family, entered in a partition within two year before his death in which he received as his share an allotment substantially lower in value than he could have legally got, there was a disposition by the deceased of his interest in the family property in favour of the other members of the family to the extent of the difference between the value of the deceased's share which he could have received and what was actually received by him and that the value of this interest was includible in the principal value of estate of the deceased liable to estate duty.

6.3.5 Hon'ble Supreme Court in the case of Rajputana Trading Co. Ltd. v. CIT held that a legal fiction is to be carried to its logical conclusion by necessary implication. When the loss or liability for which deduction had previously been allowed to the assessee arose out of speculative transactions, the origin of such loss is categorized as speculation loss, then, in that case, if such loss is to be treated as profit in the circumstances given in Section 41(1), it would be most illogical and irrational to treat the so called profits as having a neutral source and not sprang out of same category of speculative business which led the assessee incurring that loss or liability.

6.4 From above pronouncements it is clear that in interpreting a provision creating a legal fiction, the court is to ascertain for what purpose the fiction is created and after ascertaining this, the court is to assume all those facts and consequences which are incidental or inevitable corollaries to give effect to the fiction. Therefore the deeming provisions of Section 44BB not only aim at estimation of income but by necessary implication also decides that remuneration paid to expatriates is included in 90% of the amount allowed as deduction Under Section 44BB. The income of the technicians being chargeable to tax in India irrespective of the period of stay, the assessee was liable to deduct tax at source while making the payment to expatriates. Non existence of similar provision as that of Section 44AD explaining expenditure deemed to have been allowed would not make any

difference in view of interpretation of legal fiction in the immediate paragraphs by Hon'ble courts. Therefore, we do not find any infirmity in the order of CIT (A) holding that assessee was a defaulter Under Section 201(1) of the Act.

7. Ground No. 6 relates to addition of lodging and boarding provided as free of cost. The assessing officer has discussed the issue in detail.

The CIT (A) has upheld the inclusion of perquisite for the purpose of deduction of tax at source. The facilities provided free of cost are relatable to the employment and, therefore, to be charged as perquisite. We do not find any infirmity in the order of CIT (A).

8. In ground No. 7 salary paid for off period has been taken for computation of deduction of tax at source. We find that this issue is covered against the assessee by the order of I.T.A.T. B-Bench in assessee's own case for assessment year 1984-85 and 1986-87.

Respectfully following the said order we hold that CIT (A) was justified in upholding the action of Assessing Officer for inclusion of off period salary for the purpose of deduction of tax at source.

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