IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'I-1' BENCH, NEW DELHI

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND MS. SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No. 7075/DEL/2017
[A.Y 2013-14]

Giesecke & Devrient [India] Pvt Ltd Corporate Office, Plot No. 57, Sector 44, Gurgaon	Vs.	The Addl. C.I.T Special Range -04 New Delhi

PAN: AABCG 4223 D

[Appellant] [Respondent]

Assessee by	:	Shri Harpreet Singh Ajmani, Adv Shri Rohan Khare, Adv
Revenue by	:	Shri Surendra Pal, CIT-DR

Date of Hearing	**:**	**01.10.2020**
Date of Pronouncement	**:**	**13.10.2020**

ORDER

PER N.K. BILLAIYA, ACCOUNTANT MEMBER,

This appeal by the assessee is preferred against the order dated 26.10.2017 pertaining to A.Y 2013-14 framed u/s 143(3) r.w.s 144C(5) of the Income tax Act, 1961 [hereinafter referred to as 'the Act' for short].

2. Substantive grievances of the assessee can be summarised as under

(i) Transfer pricing adjustment in smart cards distribution segment which covers grounds Nos 4 to 16 of the appeal memo;

(ii) Transfer pricing adjustment on software development segment which covers Ground Nos 17 to 22 of the appeal memo

(iii) Disallowance of expenditure u/s 40a(ia) of the Act which covers ground Nos 29 to 38 of the appeal memo.

3. Representatives of both the sides were heard at length, the case records carefully perused and with the assistance of the ld. Counsel, we have considered the documentary evidences brought on record in the form of Paper Book in light of Rule 18(6) of ITAT Rules and have also perused the judicial decisions relied upon by both the sides.

4. G & D, the appellant, was incorporated in 2001 as a 100% subsidiary of G &D GmbH, with its corporate office located in Gurgaon. The appellant primarily deals in trading of Currency Verification and Processing Systems. G&D India imports these machines from its AEs for resale in India and as part of the related services, G&D also buys and

resells annual maintenance contracts to its customers in India. The appellant is also engaged in distribution and personalization of smart cards in India, which are imported from its AEs. These smart cards are for Payment Card industry and in the nature of chip cards, magnetic cards etc. The primary customer of the smart card is the banking sector. The appellant also renders software development services to G&D GmbH, wherein it develops application software for G&D GmbH for smart cards module through Development Centre India.

5. The international transactions reported by the appellant are as under:

SI. No	Nature of international transaction	Amount (in INR)	Most Appropriate Method	Segment to which transaction belongs
1	Purchase of CVPS machines and spare parts	977,335,376	Transactional net margin method ("TNMM")	CVPS distribution segment
2	Purchase of smart cards, pre-recorded smart cards, chip module, USB token,	49,229,226	TNMM	Smart Cards distribution segment

3	Provision of software development services and testing support services	296,493,097	TNMM	Software development segment
4	Provision of technical support services	118,324,496	TNMM	
5	Provision of technical and marketing support services	23,015,840	TNMM	
6	Purchase of fixed assets	573,903	TNMM	Software development
7	Purchase of fixed assets	2,871,395	TNMM	Software development
8	Payment of royalty for Intellectual and Industrial Property Rights	8,294,784	Other Method	Smart Cards segment
9	Payment of service charges	43,496,584	TNMM	CVPS distribution segment, smart card distribution and
10	Payment of IT support charges	2,736,840	TNMM	
11	Corporate guarantee	1,761,364	TNMM	
12	Reimbursement of expenses	1,776,704	Other Method	
13	Recovery of expenses	2,200,203	Other Method	

SMART CARD DISTRIBUTION SEGMENT

6. In the transfer pricing study, TNMM was taken as the most appropriate method for benchmarking trading segment dealing with imports from AEs. The appellant reported NPM from distribution of smart cards at 5.26% and compared the same with three years weighted average working capital adjusted NPM of independent comparables at 0.28%.

7. The TPO was not satisfied with the selection of comparables and after analysing the comparables, two comparables were selected, namely, Idea Telesystems Ltd and Priya Ltd., with a working capital adjusted OP/ OR at 8.75% and accordingly, proposed a TP adjustment of Rs.3,72,23,538/-. We find that the TPO took combined figures of trading and service segments of the assessee rather than restricting to the figures of trading segment. This can be seen from the computation table wherein the operating revenue is taken at Rs.13,43,67,865/- and operating cost as Rs. 15,98,34,215/-, which matches with the total of trading and service segments.

8. Objections were raised before the DRP but the DRP did not give any relief with respect to the selection of comparables. However, the DRP gave partial relief with the direction that benchmarking should be undertaken in terms of earlier years.

9. In the meanwhile, the margin of comparables was rectified from 8.75% to 6.79% and thereafter, from 6.79% to 2.52% and, accordingly, adjustment was reduced from Rs. 3,72,23,538/- to Rs.2,88,52,420/-. While giving effect to the directions of the DRP, though the TPO made reference to the orders of A.Y 2009-10 and 2010-11, and noted that adjustment is to be restricted to the value of international transaction with AES. However, an adhoc adjustment of Rs. 88,86,545/- was sustained. It appears that the TPO once again erred in taking gross numbers of trading and service segments.

10. The same can be understood from the following chart:

Sl. No	Particulars	Amount	Reference
1.	Operating Revenue [A]	13,43,67,865	Total of sales and service income in trading and service segment
2.	Arm's length margin (%) [B]	2.52%	
3.	Arm's length margin (Rs.)[C]	33,86,070	(A) X(B)
4.	Arm's length price [D]	13,09,81,795	(A) – (C)
5.	Price charged by assessee [E]	15,98,34,215	Total expenses in trading and service segment
6.	Difference [F] + E-D]	2,88,52,420	
7.	Transaction value related to purchase of sim card with AE [G]	4,92,29,226	
8.	% of transaction to revenue [H]	33.80%	(G) – /(E) X 100
9.	Difference between ALP and price charged by assessee [I] = FXH]	88,86,545/-	

11. Considering the facts discussed hereinabove, we are of the considered view that trading segment transaction should be taken into consideration wherein the appellant has shown margin of 5.26% which is more than the comparables margin of 2.52% and transaction can be safely considered at arm's length price. We have been told that in A.Y

2014–15, the TPO himself has accepted and used segmental profitability of ‘trading segment’ for benchmarking of import from AEs.

12. In our considered opinion, when segmental details are available and once segmental and allocation of costs are not disputed, then the TPO was not justified in using combined figures of trading and service segments. We, accordingly, direct the TPO to use trading segment only for determining ALP in this segment. We direct accordingly.

SOFTWARE DEVELOPMENT SEGMENT

13. At the very outset, the learned counsel for the assessee stated that without prejudice to all the rights and contentions with respect to inclusion and exclusion of set of comparables and application of filters agitated before the lower authorities, his prayer is made for exclusion of the following two comparables included by the TPO:

i) Infosys Limited, and

ii) Larsen and Toubro Infotech Limited.

14. Under this segment, the appellant has provided software development support services to its AEs with respect to smartcards business whereas under Competence Centre India Division at Gurgaon, the appellant has provided software development services to its AEs with respect to currency verification processing system business. The Development Centre India Division [DCI] is at Pune and Competition Centre India Division [CCI] is at Gurgaon. TNMM was selected as the most appropriate method for benchmarking taking NCP margin as the PLI and under DCI division, NCP margin of the assessee was at 12.62% whereas under CCI division, NCP margin was 12.02%.

15. The TPO retained 6 comparables out of 10 comparables selected by the assessee and introduced 8 new comparables and came to a final set of 14 comparables. The working capital adjusted OP/OC margin of the comparables was 20.71%. Accordingly, under DCI Division, adjustment of Rs.3,28,86,862/- was proposed and under CCI Division, adjustment of Rs.1,88,81,141/- was proposed.

16. Objections were raised before the DRP demonstrating the reasons for exclusion of Infosys Ltd and Larsen and Toubro Infotech Ltd as

comparables. However, the DRP upheld the order of the TPO vide directions dated 18.09.2017.

17. Before us, the same reasons were given for exclusion of Infosys Limited and Larsen and Toubro Infotech Ltd which were given before the lower authorities.

INFOSYS LTD

18. The risk profile of the appellant shows that it operates at minimal risk as 100% services are provided to AES whereas Infosys Ltd operates as full-fledged risk-taking entrepreneur. Further, the appellant provides software development testing support and technical support services whereas Infosys Ltd provides end to end solutions, technical consultancy, design development, re-engineering maintenance etc. along with software products. Infosys Ltd lacks segmental details and bifurcation of expenditure for software development and product is not available. The scale of operation is completely different.

19. The appellant’s income is at Rs. 252 crores whereas that of Infosys is Rs. 36,765 crores. The appellant does not own intangibles or Goodwill

whereas, Infosys Ltd has goodwill of Rs. 1,091 crores and IPR at 49 crores and further Infosys spends Rs. 250 crores on R&D expenditure. For these reasons, Infosys Ltd has been excluded from the list of comparables by the co-ordinate bench in assessee's own case for A.Ys 2008-09, 2010-11, and 2011-12 in ITA Nos. 5924/DEL/2012, 3865/DEL/2015 and 1431/DEL/2016 respectively. Considering the past history of the appellant in the light of facts mentioned hereinabove, we direct for exclusion of Infosys Limited from the final set of comparables.

LARSEN AND TOUBRO INFOTECH LTD.

20. The risk profile is the same as that of Infosys Ltd. The appellant operates at minimal risks as 100% services are provided to AEs whereas Larsen and Toubro Infotech Ltd operates as a full-fledged risk-taking entrepreneur. Similarly, the software development segment of the appellant is being compared whereas segmental details in the case of Larsen and Toubro Infotech Ltd with bifurcation of expenditure for software development and product engineering are not available. In this case also, Larsen and Toubro Ltd owns software of 132 crores. The most alarming fact is that Larsen and Toubro Infotech Ltd has un-allocable expenditure of Rs. 225.73 crores.

21. For this very reason, the coordinate bench in the case of Pitney Bowes Software India Ltd 192TTJ778 has excluded Larsen and Toubro Infotech Ltd from the final set of comparables on account of major unallocable expenses observing that in the absence of availability of nature of expenses and proper allocation case, Larsen and Toubro Infotech Ltd deserves to be rejected. Respectfully following the findings of the coordinate bench [supra], we direct for exclusion of Larsen and Toubro Infotech Ltd from the final set of comparables. Accordingly, Ground Nos 17 to 22 are allowed.

<u>DISALLOWANCE OF EXPENDITURE UNDER SECTION 40(a)(I) OF THE ACT</u>

22. The Assessing Officer has disallowed these expenses u/s 40(a)(i)of the Act on account of non-deduction of tax at source on reimbursement. The total disallowance was made at Rs.17,76,704/-.

23. When objections were raised before the DRP, the DRP directed for deletion of Rs. 4,22,386/- pertaining to training expenses and Rs. 3,21,873/- pertaining to recovery of expenses. However, balance disallowance of Rs.10,32,445/- was sustained.

24. Before us, the learned counsel for the assessee pointed out that the same pertains to pension of the Managing Director, purchase of office merchandise like calendar etc., recovery of damages to apartments etc. It is the say of the learned counsel that these are nothing but pure reimbursements and the facts of the decision of the Hon'ble Delhi High Court in the case of Centrica India Offshore Pvt Ltd 364 ITR 336 are clearly distinguishable. The learned counsel pointed out that on identical set of facts, the coordinate bench in A.Y 2011-12 has allowed the expenditure.

25. Per contra, the ld. DR strongly supported the findings of the lower authorities.

26. We find that some additional evidences were furnished before the DRP. Though the DRP has noted the additional evidences, yet followed the decision of the Hon'ble Jurisdictional High Court in the case of Centrica India Offshore Pvt Ltd [supra[. We find that the coordinate bench in A.Y 2011–12 has allowed claim of appellant observing that payment of training expenses, purchase of materials, reimbursement of training expenses and pension are not liable to the provisions of TDS.

27. Since, in the present case also the assessee has claimed that Rs.10,32,445/- pertains to pension of the Managing Director, this needs to be re-verified by the Assessing Officer. We, accordingly, direct the assessee to furnish necessary evidence relating to pension and the Assessing Officer is directed to examine the same and decide the issue in the light of the findings given by the Tribunal in assessee's own case in A.Y 2011–12. Accordingly, grounds Nos 29 to 38 are treated as allowed for the statistical purposes.

DISALLOWANCE OF ADVANCE WRITTEN OFF.

28. Facts on record show that the assessee entered into a lease deed with E-Lights Techno Park Pvt Ltd for office premises in Chennai and paid following deposits to the lessor:

- Security deposit - Rs.35,35,760/-
- Maintenance Security Deposit - Rs.11,33,256/-

29. For some reason, the assessee could not take possession of the office premises and the lessor did not repay the said security deposits.

In A.Y 2011–12, the assessee made a provision for doubtful advances but the same was added back in the computation of income. However, in the present A.Y, that is, 2013–14, as the security deposit could not be recovered, the same were written off from the provisions and claimed as deduction in computation of income.

30. The Assessing Officer disallowed the claim of write-off by holding that the same has to be considered in terms of section 36(1)(vii) read with section 36(2) of the Act, meaning thereby that the Assessing Officer treated the same as bad debts.

31. Before the DRP, the assessee furnished additional evidences and alternative claim was also made by stating that the amount written off should be considered as loss incidental to the business of the assessee.

32. The DRP did not accept the claim of the assessee.

33. Before us, the learned counsel reiterated what has been stated before the lower authorities and the ld. DR supported the findings of the Assessing Officer. We find that the assessee has furnished additional evidences before the DRP. We are of the considered view that such additional evidences should have been examined thoroughly. We,

accordingly, restore this issue to the file of the Assessing Officer. The assessee is directed to furnish all the additional evidences in support of the claim of write off and the Assessing Officer is directed to examine the same and decide the issue afresh after giving reasonable opportunity of being heard to the assessee. Ground Nos 39 to 42 are, accordingly, treated as allowed for statistical purposes.

ADDITIONAL GROUNDS

34. Vide application dated 11.09.2019, the assessee has raised the following additional grounds of appeal:

> **"Ground 3.1:** *That the Assessing Officer* **("AO")** *erred in not extending the benefit of applicable Double Taxation Avoidance Agreement between India and Germany* **("DTAA ")** *qua the rate of tax on payment of dividend to the shareholder (Giesecke & Devrient GmbH)*
>
> **Ground 3.2:** *That the AO failed to appreciate that the dividend income was that of the non-resident recipient who was governed by the provisions of relevant DTAA.*
>
> **Ground 3.3:** *That the AO also failed to appreciate that in terms of section* **90(2)** *read with section* **10(34)** *of the Act*

the income being taxable in the hands of non-resident could not be subjected a rate in excess of the rate prescribed under the DTAA and hence, erred in subjecting the Appellant to additional income tax in terms of section 115-O of the Act.

Ground 3.4: That the AO erred in not granting refund of the excess Dividend Distribution Tax paid by the Appellant, since as per the provisions of Section 237 of the Act read with Article 265 of the Constitution of India, only legitimate tax could have been retained."

35. The ld. counsel vehemently stated that the additional grounds raise a purely legal issue and, therefore, as per the ratio laiddown by the Hon'ble Supreme Court in the case of NTPC 229 ITR 383, the same deserves to be admitted and adjudicated.

36. The ld. DR strongly opposed to the admission of additional grounds. The ld. DR vehemently stated that this issue was never taken before the assessing officer nor before the DRP and it is nothing but a malafide attempt to distort the appellate proceedings. It is the say of the ld. DR that the issues raised vide additional grounds are not only legal issues but also need verification of facts. The ld. DR further stated that the lower authorities have followed due process of law and there

was no denial of natural justice and this action of the assessee is nothing short of malafide.

37. We have given thoughtful consideration to the rival contentions. We have carefully perused the additional grounds. A similar grievance was raised by way of additional ground of appeal in the case of Maruti Suzuki India Ltd 961/DEL/2014 and the Tribunal, vide interim order dated 31.10. 2019, admitted the additional ground for adjudication. The revenue approached the Hon'ble High Court of Delhi by way of writ petition and the Hon'ble High Court of Delhi in WP(C) 1324/2019, order dated 16.12.2019 was pleased to dismiss the writ petition of the revenue.

38. The relevant findings of the Hon'ble High Court read as under:

> *"The impugned order is an interlocutory order, passed by the Tribunal in the course of proceedings. It is not an order determining any rights of the parties on merits. All that the tribunal has done is to permit the respondent to raise the additional ground. The same does not tantamount to acceptance of additional ground on its merits."*

39. In light of the above, the additional ground is admitted for adjudication.

40. Representatives were heard at length. The relevant articles of Double Taxation Avoidance Act [DTAA], accordingly, perused.

41. The aforementioned additional grounds of appeal raise a purely legal issue and the issue needs to be adjudicated as to whether the Dividend Distribution Tax [DDT] levied in terms of section 115-0 of the Act should be restricted to the rate of tax on dividends as provided in the applicable DTAA governing non-resident shareholders.

42. In other words, what needs to be examined is the interplay between Section 115-0 of the Act on one hand, and Article 10 of DTAA governing taxation of dividend on the other.

43. Section 115-0 contained in chapter XVII-D of the Act reads as under:

> "**115-O**. (1) Notwithstanding anything contained in any other provision of this Act and subject to the provisions of

this section, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the 1st day of April, 2003, whether out of current or accumulated profits shall be charged to additional income-tax (hereafter referred to as tax on distributed profits) at the rate of fifteen per cent.

(1A) The amount referred to in sub-section (1) shall be reduced by,—

[85][(*i*) the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,—

(*a*) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or

(*b*) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend:

44. The genesis of charge for levy of additional Income Tax u/s 115-0 on the profits declared/distributed and paid by a corporate assessee by way of dividend can be traced to the charging provisions of Section 4 of the Act which provides as under:

“4. Charge of income- tax

(1) Where any Central Act enacts that income- tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and [2] subject to the provisions (including provisions for the levy of additional income- tax) of, this Act] in respect of the total income of the previous year] of every person.”

45. It can be seen from the above that this section provides for charge of tax, including additional Income tax on the total income of every person.

46. Section 2(24) defines “Income” which includes:

a) profits and gains; and
b) dividend.

Xxxxxx

47. Tax has been defined in section 2(43) as under:

" Tax" in relation to the assessment year commencing on the 1st day of April, 1965 , and any subsequent assessment year means income- tax chargeable under the provisions of this Act, and in relation to any other

assessment year income- tax and super- tax chargeable under the provisions of this Act prior to the aforesaid date;] and in relation to the A.Y commencing on the 1st day of April 2006, and any subsequent A.Y includes the fringe benefit tax payable u/s 115WA".

48. A perusal of the above shows that the term "Tax" would cover additional Income Tax levied u/s 115-0 of the Act.

49. The first critical issue, which needs to be decided, is as to whether the DDT is tax on the company or the shareholder since the admissible surplus stands reduced to the extent of DDT. We are aware of the decision of the Hon'ble Bombay High Court in the case of Godrej and Boyce Manufacturing Company Limited 328 ITR 81 though the same was rendered in the context of section 14A r.w.s 115-0 of the Act. The relevant findings of the Hon'ble Bombay High Court read as under:

"35. Section 115-O has been enacted with a view to exempt dividend income. Prior to the insertion of Section 115-O, domestic companies were liable to pay tax on the total income (including profits distributed as dividends) and shareholders were liable to pay tax on dividend income received. Domestic companies distributing profits as dividends were liable to deduct tax at source and shareholders receiving the dividend

were entitled to take credit of such tax deducted at source. As this method was found to be cumbersome, Parliament chose to exempt dividend income in the hands of the shareholder and chose to levy additional income-tax on the amount of profits declared, distributed or paid as dividend by the domestic companies. Thus, by inserting Section 115-O, additional income-tax is levied on the amount of profits declared, distributed or paid as dividend and by inserting Section 10(33) it is made clear that the dividends referred to in Section 115-O would be exempt from tax."

50. Thus, it can be stated that the Hon'ble Bombay High Court has unequivocally held that DDT is tax 'on the company' and not 'on the shareholder'.

51. There is no dispute that the liability is on the payer company to pay DDT, but, at the same time, we must not lose sight of the fact that additional Income tax is part of tax as defined in Section 2(43) of the Act and levy of additional Income tax u/s 115-0 has its genesis in charging provision of Section 4 of the Act. We must also remember that this additional Income tax [DDT] levied u/s 115-0 is a tax on income and definition of "Income" includes dividend.

52. As per the Income Tax Rules, relevant details regarding payment of DDT have to be provided in the Income Tax return form and have to be disclosed in the Tax Audit Return [Form 3CD]. Further, the Income tax assessment order read with the Income tax computation form quantifies DDT liability. It would not be out of place to mention that the Act does not provide for a separate adjudication/passing of separate order with regard to adjudication of liability of DDT. Section 115-Q merely provides for the consequences of non-payment of DDT, but there is no separate/specific provision in the Act for collection and recovery of DDT in default.

53. At this stage, it is important to examine the legislative history of section 115-0 of the act. The Memorandum to the Finance Bill, 1997 discusses the erstwhile system of collecting Income tax on profits distributed by the companies and relevant extract is reproduced as under:

> *"Under the existing system of collection of tax on dividends, every company, at the time of paying dividend to a shareholder in excess of 'Rs. 2500, is required to deduct tax at the specified rate and deposit it in the Central Government*

account. The company is also required to issue TDS certificates to all shareholders in whose cases the tax has been deducted. The shareholders, in turn, have to show the dividend m their return of income and pay the tax at the rate applicacle in their case. They also have to enclose the TDS certificates along with the return and claim credit for the tax deducted at source. Many a time, the tax deducted or a part thereof is required to be refunded to the assessee. Thus, the procedure for tax collection is cumbersome and involves a lot of paper work."

54. Memorandum to the Finance Bill 2003 reiterates that it is easier to collect Income Tax from a single point, [that is, from the company distributing the dividends] rather than compel the companies to compute income tax deductible from the dividend income in the hands of the shareholders.

55. Memorandum to Finance Bill 1997 and 2003 clearly establish that levy of tax on the company was driven by administrative considerations rather than legal necessity and further emphasis on the fact that levy is for all intents and purposes, a charge on dividends. Even if we go by economical considerations, the burden of DDT falls on the shareholders rather than on the company, as the amount of distributed profits available for shareholders stands reduced to the extent of DDT levied.

56. As mentioned elsewhere, section 4 provides for charge of Income tax and Section 5 provides that total income of resident includes all income which is :

(a) received or is deemed to be received in India

(b) accrues or arises or is deemed to accrue or arise in India

(c) accrues or arises outside India during the previous year.

57. In the case of non-resident, total income includes all income from whatever source derived,

(a) received or is deemed to be received or

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

58. The provisions of section 4 and 5 of the Act are expressly made "subject to the provisions of this Act" which would include section 90 of the Act. Section 90(2) of the Act provides "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 maybe, under sub-section (1) for granting relief of tax or as the case

maybe, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, provisions of this Act shall apply to the extent they are more beneficial to the assessee.

59. The Hon'ble Andhra Pradesh High Court in the case of Visakhapatnam Port Trust 144 ITR 146 held that provisions of sections 4 and 5 of the Act are made subject of the provisions of the Act which means that they are subject to provisions of section 90 of the Act by necessary implication they are subject to terms of DTAA, if any, entered into by the Government of India.

60. The Hon'ble High Court of Calcutta in the case of CIT Vs. Devi Ashmore India Ltd 190 ITR 626, while dealing with the correctness of Circular number 333 dated 2nd April, 1982 137 ITR statute 1 held that:

> "*The conclusion is inescapable that, in case of inconsistency between the terms of the Agreement and the taxation statute, the Agreement alone would prevail.*"

61. The Hon'ble Calcutta High Court in the case had expressly approved the correctness of CBDT Circular No. 333 dated 02.04.1982 on

the question as to what the Assessing Officer would have to do when they found that the provisions of DTAA were not in conformity with the Income tax Act.

62. Observations of the Hon'ble Supreme Court in the case of Union of India and Another Vs Azadi Bachao Andolan 263 ITR 706 is most relevant, the findings of which read as under:

> *"A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a double taxation avoidance agreement. When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would operate even if inconsistent with the provisions of the Income-tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under section 4 and the general principle of ascertainment of total income under section 5 of the Act, then there was no purpose in making those sections "subject to the provisions" of the Act". The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under section 90 towards implementation of the terms of the DTAs which would automatically override the*

provisions of the Income- tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of the DTAC.

63. We have already discussed the Memorandum to the Finance Bill 1997 and 2003. It would be very pertinent to discuss the Memorandum to the Finance Bill, 2020 by which section 115-0 is removed. In this Finance Bill, it has been specifically mentioned for removal of DDT and moving to classical system of taxing dividend in the hands of shareholders. It has been mentioned in this bill that incidence of tax is on the payer company and not on the recipient where it should normally be as the dividend is income in the hands of the shareholders and not in the hands of the company. The incidence of tax should therefore, be on the recipient.

64. Moreover, the present provisions levy tax at a flat rate on the distributed profits across the board irrespective of marginal rate at which recipient is otherwise taxed the provisions are hence considered iniquitous and regressive. The present system of taxation of dividend in the hands of the company was re-introduced by the Finance Act 2003 since it was easier to collect tax at a single point and new system was leading to increase in compliance burden. In view of the above, it is

proposed to carry out amendments so that dividend is taxable in the hands of the shareholders at the applicable rates and the domestic company is not required to pay DDT.

65. A conjoint reading of the Memorandum to Finance Bill 1997, 2003 and 2020 would show that levy of DDT was merely for administrative conveniences and withdrawal of DDT is keeping in mind that revenue was across-the-board, irrespective of marginal rate, at which recipient is otherwise taxed.

66. To recapitulate, the DDT is levy on the dividend distributed by the payer company, being an additional tax is covered by the definition of 'Tax' as defined u/s 2(43) of the Act which is covered by the charging section 4 of the Act and charging section itself is subject to the provisions of the Act which would include section 90 of the Act.

67. In our humble opinion, the liability to DDT under the Act which falls on the company may not be relevant when considering applicability of rates of dividend tax set out in the tax treaties. The generally accepted principles relating to interpretation of treaties in the light of

object of eliminating double taxation, in our view does not bar the application of tax treaties to DDT.

68. In light of the above, let us now consider the India Germany DTAA, which is under consideration in the present additional ground of appeal.

"Notification No. G. S. R. 836(E), dated 29th November, 1996

Whereas the annexed Agreement between the Government of the Republic of India and the Government of the Federal Republic of Germany for the avoidance of double taxation with respect to taxes on income and capital has been concluded;

And, whereas, the aforesaid agreement was brought into force on the 26th day of October, 1996, after the completion by both the Contracting States to each other of the procedure required under their laws in accordance with Article 28 of the said Agreement;

Now, therefore, in exercise of the powers conferred by section 90 of the Income-tax Act 1961 (43 of 1961), and section 44A of the Wealth-tax Act, 1957 (27 of 1957), the Central Government hereby directs/that all the provisions of the said Agreement shall be given effect to in the Union of India."

Article 10 – Dividends

(1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

(2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 10 per cent of the gross amount of the dividends.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

(3) The term "dividends" as used in this article means —

(a) dividends on shares including income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, and

(b) other income which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

(4) The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting

State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 or Article 14, as the case may be, shall apply.

(5) Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject to the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State."

69. The date of this notification is very relevant, which is, 29.11.1996 whereas, as mentioned elsewhere, section 115-O was inserted in the Act by Finance Bill, 1997 which means that the DTAA between India and Germany is pre dated to the amendment. Clause (2) of the aforesaid

Article 10 clearly mentions that the dividends may also be taxed in the contracting state on which the company paying the dividend is a resident. However, a rider is also put that if the resident is beneficial owner of the dividend, the tax so charged shall not exceed 10% of the gross amount of the dividend.

70. The Hon'ble Jurisdictional High Court at Delhi in the case of New Skies Satellites 382 ITR 114 had an occasion to consider the amendment to the Act vis a vis the international treaty and the Hon'ble High Court held as under:

> *"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.

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, where the Indo Mauritius Double Tax Avoidance Convention was before the Supreme Court, the Court said the following of the essential nature of these treaties, ". 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 go ahead 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 , Pg.4 (London Sweet & Maxwell, 1985)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 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."

43. The Vienna Convention on the Law of Treaties, 1969 ("VCLT") is universally accepted as authoritatively laying down the principles governing the law of treaties. Article 39 therein states the general rule regarding the amendment of treaties and provides that a treaty may be amended by agreement between the parties. The rules laid down in Part II of the VCLT apply to such an agreement except insofar as the treaty may otherwise provide. This provision therefore clearly states that an amendment to a treaty must be brought about by agreement *between the parties. Unilateral amendments to treaties are therefore categorically prohibited.*

44. We do not however rest our decision on the principles of the VCLT, but root it in the inability of the Parliament to effect amendments to international instruments and directly and logically, the illegality of any Executive action which seeks to apply domestic law amendments to the terms of the treaty, thereby indirectly, but effectively amending the treaty unilaterally. As held in Azadi Bachao Andolan39these treaties are creations of a different process subject to negotiations by sovereign nations. The Madras High Court, in Commissioner of Income Tax v VR. S.RM. Firms Ors40 held that "tax treaties are...... considered to be mini legislation containing in themselves all the relevant aspects or features which are at variance with the general taxation laws of the respective countries".

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52. Thus, an interpretive exercise by the 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 the 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. The 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 the 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 operationalizing 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.*

53. Finally, States are expected to fulfill their obligations under a treaty in good faith. This includes the obligation to not defeat the purpose and object of the treaty. These obligations are rooted in customary international law, codified by the VCLT, especially Article 26 (binding nature of treaties and the obligation to perform them in good faith); Article 27 (Internal law and observance of treaties, i.e provisions of internal or municipal law of a nation cannot be used to justify omission to perform a treaty); General rule of interpretation under Article 31(1) (i.e. that it shall be interpreted in good *faith, in accordance with ordinary meaning to be given to the terms of a treaty) and Article 31 (4) (A special meaning shall be given to a term if it is established that the parties so intended).*

The expression "process" and treaty interpretation in this case."

71. In light of the aforesaid decision, we are of the considered view that tax rates specified in DTAA in respect of dividend must prevail over DDT.

72. Article 10.4 above specifies that clause 1 and 2 will not be applicable if beneficial owner of dividend carries on business in other contracting state of which the company paying dividend is a resident through PE situated therein. Though supporting documents have been filed before us, but these documents need verification from primary officer, that is, the Assessing Officer. We, therefore, deem it fit to restore this issue for limited purpose of verification in the light of the aforesaid Articles of DTAA.

73. Considering the above in totality, in our considered opinion, the DDT levied by the appellant should not exceed the rate specified in Article 10 in India Germany DTAA.

74. The additional ground is, accordingly, allowed on principle, though subject to verification as directed hereinabove.

75. In the result, appeal of the assessee in ITA No. 7075/DEL/2017 including the additional ground is allowed in part for statistical purposes.

The order is pronounced in the open court on 13.10.2020.

Sd/-	**sd/-**
[SUCHITRA KAMBLE**]**	**[N.K. BILLAIYA]**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: 13th October, 2020

VL/

Copy forwarded to:

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

Asst. Registrar,
ITAT, New Delhi

Date of dictation	
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	08.10.2020
Date on which the final order is uploaded on the website of ITAT	08.10.2020
Date on which the file goes to the Bench Clerk	08.10.2020
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	