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Tax rate applicable to a Permanent establishment in India same as Indian Banks per non-discrimination clause

Permanent establishment in India to pay tax at same rate as applicable to Indian companies carrying out same activities, under non-discrimination clause of India Japan DTAA

On 7 August 2019, the Calcutta High Court[1] held that a permanent establishment of a foreign bank (taxpayer) in India, was liable to pay tax at the same rate as applicable to Indian companies carrying on similar activities, in view of the non-discrimination Article under the Indian-Japan tax treaty.

Facts of the case

- The taxpayer had a permanent establishment of a Japanese Bank, in India.
- For the assessment year 1991-92, the ITAT vide order dated 31 March 1997 held that that rate of tax applicable to the taxpayer should be 65 percent and not the rate of tax applicable to the domestic company in India as the CBDT had not issued a circular as was issued in the case of ABN Amro Bank.
- The taxpayer filed an appeal before the High Court against the Kolkata Tribunal order.
- Article 24(2) of the India Japan DTAA provided as under:

  "2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other Contracting State than the taxation levied on enterprises of that other Contracting State carrying on the same activities.

  This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents."

Decision of the High Court

The High Court has held that:

- When there is no dispute that there is a double taxation avoidance agreement in place between India and Japan and when such agreement contains a lucid clause as apparent from Article 24(2) thereof and when Section 90 of the Act itself recognises such an agreement and creates a special status for the relevant permanent establishments, and section 90(2) provides that the provisions of the Act shall apply to a permanent establishment of a Japanese entity in India 'to the extent they are more beneficial to that assessee", there was no room for either the Commissioner to wait for any dictat from the high command of the CBDT or for the Tribunal to demonstrate similar servile conduct in not appropriately interpreting and giving effect to the clear words of the agreement between the two countries.
- The stand taken in the Tribunal's order dated 31 March 1997 cannot be appreciated or accepted since a similar clause in the DTAA between India and the Netherlands was interpreted

by the Central Board for Direct Taxes (CBDT) and a circular was issued thereupon. The Tribunal held, in the present case, that since there was no similar circular, the benefit as available to a permanent establishment of ABN Amro Bank in India could not be extended to the PE of the taxpayer.

- The Tribunal was incorrect in holding that the rate of tax applicable to the taxpayer was 65 percent. The Tribunal ought to have held that the rate applicable to the assessee was such rate as applicable to a domestic company carrying on similar activities.

Our comments

The High Court decision is for the AY 1991-92.

The High Court appears to be referring to the letter issued by the CBDT in 1994 to ABN AMRO Bank in the context of the DTAA between India and Netherlands but appears to have not considered the following:

- Subsequent letter issued by CBDT in 2000 to ABN AMRO Bank
- The Explanation 1 to section 90 of the Act inserted by the Finance Act 2001 w.r.e.f. 1 April 1962
- The Kolkatta Tribunal decision dated 17 June 2005 for the AY 1992-93 till 1995-96 in the case of ABN AMRO Bank wherein it was held that Explanation 1 to Section 90 is attracted and the letters issued by the CBDT have been superseded by the said Explanation w.e.f. 1st April, 1962
- Adverse Mumbai Tribunal Decisions in various bank's case

The CBDT had issued a letter No. D.O. No. 500/45/94-FTD, dated 21st. Nov., 1994, to the Chief CIT-II, whereby the Board expressed the view that ABN AMRO Bank was liable to tax at the same rate as applicable to Indian companies. The said letter was modified by the CBDT subsequently *vide* letter dated 24 March, 2000. It was clarified therein that action could be taken by the AO for application of higher rate of tax in respect of the respective assessment years barring the years covered by the aforementioned letter dated 21 Nov., 1994. The D.O. No. 500/45/94-FTD, dated 21 Nov., 1994, was issued by CBDT in response to reference from Embassy of Netherlands. [ABN Amro Bank NV vs Joint Commissioner of Income Tax (2005) 96 TTJ Kol 1041.]

Explanation 1 in section 90 was introduced by the Finance Act 2001 w.e.f 1 April 1962 and provides that "For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company."

The Mumbai Tribunal in various cases have held that Explanation 1 to section 90 of the Act applies in case of PE of foreign banks and so higher rate of tax on income of the PE of foreign banks is not a discrimination under the provisions of the Treaty.

[1] Bank of Tokyo Mitsubishi Ltd. v. CIT (2019) 108 taxmann.com 242 (Calcutta)

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