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## Interest paid by an Indian branch of US bank is not taxable under the Act, being payment to self, prior to AY 2016-17

Explanation (a) to section 9(1)(v)(c) of the Income-tax Act, 1961 inserted by Finance Act, 2015 is prospective in nature and cannot be applied prior to AY 2016-17

The Mumbai Tribunal in JP Morgan Chase Bank N.A has held that interest paid by an Indian branch of a US bank to its head office/ overseas branches shall not be deemed to accrue or arise in India for any assessment year prior to AY 2016-17.

### Facts of the case:

JP Morgan Chase Bank N.A. (the taxpayer) [1] is a non-resident banking company incorporated in USA. The taxpayer carries on its banking activities in India through its branch located in Mumbai. In the return of income filed for the assessment years 2011-12 and 2012-13, the taxpayer has not brought to tax the interest income received from Indian branch and has appended a note explaining in detail the reasoning for not offering such income to tax. In the course of assessment proceedings, the Assessing Officer had made specific enquiry with regard to the interest income earned and accepted the taxpayer's claim that interest paid by the Indian branch to head office/overseas branches is not taxable as it is considered to be a payment made to self, hence, governed under the principle of mutuality.

Subsequent to completion of assessment, the learned Commissioner of Income-tax (CIT), in exercise of power conferred under section 263 of the Income-tax Act, 1961 (the Act), called for the assessment records for the years under dispute. The CIT has held that the assessment orders passed for the AY 2011-12 and AY 2012-13 are erroneous and prejudicial to the interest of revenue and directed the Assessing Officer to tax the interest income received from the Indian branch by head office/ overseas branches in the hands of the head office/overseas branches. The observations of the learned CIT were as under:-

- Once the taxpayer opts to be governed under the beneficial provisions of the DTAA and it is accepted that it has PE in India, the single entity approach under the Act gives way to the distinct and independent entity or separate entity approach under the DTAA.
- The interest is taxable as per Article 14(3)[2] of the India USA DTAA.
- CBDT Circular no.740 dated 17 April 1996 states that the branch of a foreign company in India is a separate entity for the purpose of taxation under the Act.
- Explanation (a) to section 9(1)(v)(c) of the Act introduced by Finance Act, 2015, w.e.f. 1st April 2016 has also clarified that the interest paid by an Indian branch of a non-resident banking company shall be deemed to be accruing or arising in India and shall be chargeable to tax in addition to any income attributable to the PE in India. The explanation further says that the PE

[1] 114 taxmann.com 700

[2] Article 14(3) of the India USA DTAA - In the case of a banking company which is a resident of the United States, the interest paid by the permanent establishment of such a company in India to the head office may be subject in India to a tax in addition to the tax imposable under the other provisions of this Convention at a rate which shall not exceed the rate specified in paragraph 2(a) of Article 11 (Interest).

in India shall be deemed to be a person separate and independent of the non-resident person. The learned CIT was of the view that the aforesaid explanation should apply retrospectively since such amendment is clarificatory in nature.

- The decision of Special Bench of the Mumbai Tribunal in the case of Sumitomo Mitsui Banking Corpn.[3] has not been considered by CIT since such decision had not considered various arguments provided by him in the context of treaty provisions.

Aggrieved by the order passed by CIT, taxpayer preferred an appeal before the Income Tax Appellate Tribunal (ITAT).

## Decision of ITAT:

- The Tribunal observed that the issue of taxability of the interest paid by the Indian branch to the head office/other overseas branches of non-resident banking company is squarely covered by the decision of the Special Bench of the Tribunal in the case of Sumitomo Mitsui Banking Corpn. *(supra)*. The Special Bench after considering all the aspects of the issue, including the interplay between the provisions of the Act and the Tax Treaty, has held that the interest paid by the Indian branch to foreign head office/overseas branches is in the nature of payment made to self, will be governed by the principle of mutuality and hence would not be taxable under the provisions of the Act. Since the provisions of the Act are more beneficial to the taxpayer, it will prevail over the provisions of the Tax Treaty as per section 90(2) of the Act.
- Further, the Special Bench decision also referred to the CBDT Circular no.740 dated 17 April 1996, and held that if the interest income is not chargeable to tax under the provisions of domestic law, it cannot be brought to tax by way of a Board circular.
- To nullify the effect of the Special Bench decision, the legislature had thought it prudent to make amendment to the provisions of section 9(1)(v)(c) of the Act. Accordingly, the amendment was made to the aforesaid provision by introducing Explanation (a) and (b) by Finance Act, 2015, w.e.f. 1st April 2016. The Tribunal has held that the aforesaid explanation would apply prospectively with effect from 1st April 2016 and not prior to that. Similar view has been expressed by the Co-ordinate Bench in the case of BNP Paribas S.A[4].
- Assuming for the sake of argument that Explanation (a) to section 9(1)(v)(c) of the Act will apply retrospectively, the Tribunal held that proceedings under section 263 of the Act cannot be initiated on the basis of retrospective amendment as the Assessing Officer has to proceed on the basis of law prevailing as on the date of assessment and the order passes cannot be considered to be erroneous or prejudicial to the interest of revenue.

## Observations:

India USA DTAA has a specific Article 14(3) for taxation of such interest income received by the HO from the Indian branch of the US Bank. However since such interest income was not taxable under domestic tax law prior to AY 2016-17, such interest income was held to be not taxable in India for the AY 2011-12 and 2012-13.

The issue with respect to the prospective or retrospective applicability of Explanation (a) to section 9(1)(v)(c) of the Act has been a matter of debate. It is a settled principle of statutory construction that every statute is *prima facie* prospective unless it is expressly or by necessary implications made

[3] 19 taxmann.com 364/136 ITD 66

[4] 109 taxmann.com 391

to have retrospective operations. The Tribunal has observed that Explanation (a) to section 9(1)(v)(c) of the Income-tax Act, 1961 inserted by Finance Act, 2015, is prospective in nature and cannot be applied prior to AY 2016-17. Therefore, interest paid by an Indian branch of a non-resident banking company to the head office/ overseas branches should not be deemed to accrue or arise in India under section 9(1)(v)(c) of the Act for any assessment year prior to AY 2016-17.

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