IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI 'I' BENCH, MUMBAI

[Coram: Pramod Kumar(Vice-President)
and Saktijit Dey (Judicial Member)]

ITA No.:6108/Mum/2018
Assessment year: 2014-15

Joint Commissioner of Income Tax
OSD- International Taxation Circle 3(2)(1), Mumbai ……………….Appellant

Vs

Merrill Lynch Capital Market Espana SA SV ………….Respondent
[PAN: AACCM7105R]

Appearances by
Avaneesh Tiwari *for the appellant*
Nitesh Joshi, *for the respondent*

Date of concluding the hearing	:	September 18, 2019
Date of pronouncement of the order	:	October 11, 2019

O R D E R

Per Pramod Kumar VP:

1. By way of this appeal, the appellant Assessing Officer has challenged the correctness of the order dated 24th August 2018 passed by the Commissioner of Income Tax (Appeals) in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2014-15.

2. In ground no. 1, the appellant Assessing Officer has raised the following grievance:

> **1. "Whether on the facts and circumstances of the case and in law, the Ld.CIT(A) erred in treating receipt of income on account of gain on foreign exchange transaction amounting to Rs. 492,92,52,900/- in the nature of income from capital gains as per Article 14(6) of India Spain Treaty and not taxable in India without appreciating the fact that the Assessee being a Foreign Institutional Investor is refrained from undertaking any other business activity and accordingly the receipt on account of foreign exchange transaction will be in the nature of income from other source or**

other income taxable in India as per Article 23(3) of the DTAA between India and Spain."

3. Learned representative have fairly agreed that whatever we had decided in ITA No. 6109/Mum/2018, which deals with identical grievance of the Assessing Officer for the Assessment Year 2013-14 and which was heard along with this appeal, will apply *mutatis mutandis* this year as well.

4. Vide our order of even date, we have dismissed similar ground of appeal, raised by the appellant Assessing Officer for the assessment year 2013-14, and while doing so, we have, *inter alia*, observed as follows:

> *5. In our humble understanding, irrespective of whether the gains in question are found to be in the capital filed or in the revenue field, the case of the revenue hinges on the applicability of Article 23 of Indo Spanish tax treaty to the gains in question. It is not even the case of the Assessing Officer that the gains can be taxed as business income in the hands of the assessee, in the absence of a PE in India, or as a Capital Gain as these are not specifically covered by any of the exemption clauses in the article 14 and the residuary taxation rights are with the residence jurisdiction. The short case of the revenue is that as the gains in question are neither covered by article 7 nor by article 14, its taxability must be examined under article 23 which gives residuary taxation rights to source jurisdiction. It is, therefore, necessary to understand the nature and scope of article 23 dealing with, what it terms as, 'Other Income'. The relevant provision is as follows:*
>
> ***ARTICLE 23- OTHER INCOME***
>
> ***1. Subject to the provisions of paragraph 2, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing Articles of this Convention, shall be taxable only in that Contracting State.***
>
> ***2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment, or fixed base. In such a case, the provisions of Article 7 or Article 15, as the case may be, shall apply.***
>
> ***3. Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Convention, and arising in the other Contracting State may be taxed in that other State.***
>
> *(Emphasis, by underlining, supplied by us)*

6. A plain reading of the above treaty provision shows that Article 23 comes into play only when an item of income of a resident of a contracting state is such that it is not expressly dealt with in the preceding articles (i.e. article 6 to 22) of the tax treaty. What is important to note is that it is not the fact of taxability in the other treaty provisions, but the fact that the income is of such a nature that it is not "expressly dealt with" in the treaty provisions, that triggers the application of article 23 and the resultant taxability of such an income in the source jurisdiction.

7. As a corollary to this proposition, it would seem only elementary that an income cannot be brought within the ambit of source taxation under article 23 just because its taxability has failed, on account of not fulfilling the conditions precedents to its source taxability in the relevant treaty provisions, in the source jurisdiction.

8. To put it in simple words, therefore, it is not the fact of non-taxability under article 6-22 which leads to taxability under article 23, but the fact of income of that nature being covered by article 6-22 which can lead to taxability under article 23. There could be many such items of income which are not covered by these specific treaty provisions, such as alimony, income from chance such as lottery or gambling, rent paid by resident of a contracting state for the use of an immovable property in a third state, and damages (other than for loss of income covered by articles 6-22) etc.

9. In our humble understanding, therefore, article 23 does not apply to items of income which can be classified under sections 6-22 whether or not taxable under these articles, and when income from gains on settlement of forward contracts is covered by Article 7 or Article 14 when conditions laid down therein are satisfied, article 23 would not have any application in the matter. Let us, in the light of this understanding about the scope of article 23, move ahead.

10. The stand of the assessee, as rightly noted by the Assessing Officer, is that the taxability of gains in question can either be taxed in the hands of the assessee under article 7 or article 14 of the Indo Spanish tax treaty, but the since the conditions precedents for such a taxability are not satisfied, the assessee cannot be taxed in India under these provisions. While we will deal with Article 14 in a detail with other grounds of appeal and the Assessing Officer has not even claimed taxability under article 14, we deem it fit and proper to set out the provisions of Article 7 of Indo Spanish tax treaty which are as follows:

> ***ARTICLE 7- BUSINESS PROFITS***
>
> ***1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.***

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make 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 enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses, research and development expenses, interest and other similar expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

11. There cannot be any dispute that the assessee has entered into forward exchange contracts in the course of its business. Grievance of the Assessing Officer at best is, to quote his words, "as an investor, the assessee cannot carry out any business activity", and, therefore, it cannot be said to be a business activity.

12. That line of reasoning, however, does not appeal to us.

13. The absence of regulatory approvals, even if that be so, does not alter the character of business activities. The law is very well settled on this issue. Even an illegal business is a business nonetheless. Whether an assessee carries out business with the requisite regulatory approvals, or without such regulatory approvals, the business activities continue to business activities nevertheless. In the case of ***CIT Vs S C Kothari [(1971) 82 ITR 794 (SC)]****, Hon'ble Supreme Court had an occasion to deal with question whether the loss incurred on alleged illegal contracts, in violation of Forward Contracts (Regulation) Act, 1952, could be set off against the income of the assessee. It was in this context that Their Lordships observed that "****If the business is illegal neither the profits earned nor the losses incurred would be enforceable in law, but that does not take the profits out of the taxing statute. Similarly, the taint of illegality of the business cannot detract from the losses being taken into account for computation of the amount which can be subjected to tax as "profits" under section 10(1) of the Act of 1922*** *(which is pari materia with Section 28 of the Income Tax Act, 1961)". In other words, even profits of illegal business were held to be taxable as 'business profits'. In* ***CIT Vs Piara Singh [(1980) 124 ITR 40 (SC)]****, the same position was reiterated. Of course, there are subsequent legislative developments with respect to admissibility, or rather inadmissibility, of deduction for "any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" but that aspect of the matter is not relevant for the present purposes.*

14. In our considered view, therefore, it can be safely concluded that whether legal or illegal, and, therefore, whether with regulatory approvals or without regulatory approvals, fruits of pursuits in the course of business are taxable as business profits nevertheless.

15. The situation under the tax treaties is no different either.

16. Article of 7 of the Indo Spanish tax treaty also refers to "profits of an enterprise" and does not even remotely suggest the compliance with all regulatory framework as a sine qua non for this treaty protection.

17. The stand of the Assessing Officer, on this aspect of the matter, i.e. taxation as non-business income, is thus wholly unsustainable in law. In any event, for the detailed reasons set out a short while ago, article 23 would not come into play for taxation of income which has not been taxed under article 6-22, even though it could have been taxed under one of these articles but for non-satisfaction of the conditions precedents for taxability under the related article. If a Spanish tax resident was to make gains by entering into forward exchange contracts in India, and such a Spanish tax resident had a PE in India from which such activities were to be carried out, the profits of such an adventure would have been taxable in India under article 7. We may, at the cost of repetition, add that it is not the fact of non taxability of an income under article 6-22, but the nature of income not being inherently taxable under these articles, which brings an income in the ambit of article 23.

18. Once we note that the forward exchange contracts were entered into, with the regulatory approval or without the regulatory approval, in the course of business, such contracts could either be in the revenue field or in capital field. These two paths are mutually exclusive, and we cannot visualize a third path.

19. If a view is taken that these gains are in the capital field, the gains are taxable as capital gains which are governed by article 14 of Indo Spanish tax treaty. The broad thrust of this provision is that except in the cases specified, i.e. under article 14(1) to 14(5), the capital gains are taxable only in the residence jurisdiction. It is not the case of the Assessing Officer that the gains on settlement of forward foreign exchange contracts are covered by any of the exception clauses. In response to our specific question also, learned Departmental Representative could not point out the specific provisions of Article 14(1) to 14(5) by which these gains are covered. We have also carefully perused these clauses and we donot find that any of the exception clauses could be invoked on the facts of this case. Therefore, we find that while taxability of such gains, i.e. capital gains, is covered by article 14, the gains are not taxable in the source jurisdiction, as the conditions precedents to the taxability in source jurisdiction, i.e. coverage by article 14(1) to 14(5), are not satisfied.

20. In the event, however, one is to come to the conclusion that these gains are in the revenue field, these gains are in the nature of business profits, governed by article 7, which cannot be taxed in the source jurisdiction as the assessee does not have any permanent establishment in India.

21. We thus find that while taxation of business profits is expressly dealt with by article, these business profits cannot be taxed in the source jurisdiction for want of satisfying the fundamental condition precedent for its taxability, i.e. existence of a permanent establishment (PE) in the source jurisdiction. Whichever way one looks at the gains in question, the taxability of these gains is very well expressly dealt with by the provisions of article 7 or article 14 of the Indo Spanish tax treaty. In the light of this analysis, in our considered view, article 23 has no application in the matter.

22. As we part with this ground of appeal, we may also deal with the judicial precedents cited before us. The common thread in all these precedents is the emphasis on the gains being in the nature of income from bonafide hedging contracts and reliance on Citicorp Banking Corporation's case (supra). It is interesting to note that in Citicorp Banking Corporation's case (supra) the issue requiring the adjudication by the Tribunal was whether the loss on cancellation of forward contracts, by an FII, could be set off against its long term capital gains taxable under section 115AD. The Assessing Officer had held that loss or gains on cancellation of forward foreign exchange contracts could not assessed under section 115AD(1)(b), and this action was confirmed by the CIT(A). When the matter travelled in appeal before a coordinate bench of this Tribunal, it was held that as the gains and losses on the forward foreign exchange contracts were to hedge the investments in question, which were admittedly taxable under section 115AD, "capital loss having direct nexus with the investment of the assessee and hence the assessee is entitled to set off the same". This decision held that such gains will also be covered by taxation under section 115AD, and will take the same colour as the main transaction, in respect of which forward contracts to hedge the investment currency risk were entered into.

23. The judicial precedent, by which it was taken as covered issue, did not even deal with the provisions of any tax treaty, much less Indo Spanish tax treaty, and it has no bearing on the question as to whether the gains on foreign exchange forward contracts could be granted protection of Article 14 of Indo Spanish tax treaty from taxation in the source state or as to whether the gains on foreign exchange forward contracts could be taxed in the source jurisdiction under article 23 of the Indo Spanish tax treaty. Yet, almost mechanically, even after noting the specific case of the

Assessing Officer on application of article 23, the matter has all along been treated as covered by Citicorp Banking Corporation's case (supra). Even when we were examining the matter in the court room, the entire focus was on the forward exchange contracts being in the nature of contracts to hedge investment currency risk. That aspect anyway remains unsubstantiated as no one to one nexus of the forward foreign exchange contracts with the investment currency risk exposure was demonstrated before us nor, despite our specific question on this issue, was it explained as to how, in a situation in which rupee value was constantly going down, these forward contracts settlements have resulted in gains rather than losses.

24. Be that as it may, we see no need to examine, or to follow, the approach adopted in these judicial precedents, as, in our considered view and from our perspective, that aspect of the matter is not really material given the undisputed facts of the present case. We are dealing with a treaty situation. To put a question to ourselves, would it really matter if these were not hedging contracts and the assessee was infact making money out of dealing in forward exchange contracts simplictor? In view of our detailed analysis earlier and in our humble understanding, that fact, by itself, cannot make the gains taxable under article 7 when the assessee does not have a PE in India, or under article 14 when the gains are not covered by any of the exception clauses in article 14(1) to 14(5). It is not, in a way, even the case of the Assessing Officer that these gains of the assessee are taxable in India under article 7 or article 14; his case is that these gains, admittedly outside the scope of article 7 and 14, are covered by article 23 as such. The question thus remains as to what is the scope of taxation in the source jurisdiction under article 23- an aspect which has not left intact by the judicial precedents relied upon and which, in fact, is the foundational issue raised in this appeal. Our decision is based on our analysis of these aspects, and our conclusion is that, under the Indo Spanish tax treaty, the assessee does not have any tax liability in respect of the transactions in question.

25. In view of these discussions, as also bearing in mind entirety of the case, we approve the conclusions arrived at by the learned CIT(A) and decline to interfere in the matter.

5. We see no reason to take a different view than the view taken by us for the assessment year 2013-14. Respectively following the same, we reject the grievance raised by the Assessing Officer and confirm the confusion arrived at by the learned CIT(A). There is, thus, no interference in the matter.

6. Ground No.1 is accordingly dismissed.

7. In Ground Nos. 2 to 6, the appellant Assessing Officer has raised the following grievance:

2. "Whether on the facts and circumstances of the case and in law, the Ld. CIT(A) erred in treating the Capital loss of Rs. 71,00,01,126/- on sale of shares of companies engaged in real estate development activities classified under BSE Realty Index as exempt under Article 14(6) of the India-Spain DTAA and not taxable in India without appreciating the fact that Article 14(4) of the DTAA is very clear & unambiguous on the issue &

sale of such shares should have been held as taxable in India as per the same."

3. "Whether on the facts and in the circumstances of the case and in law, the Id.CIT(A) erred in not appreciating the fact that the Assessing Officer has rightly held that right to occupy immovable properly is nowhere mentioned in Article 14(4) of the DTAA and India is not a signatory to the UN Model."

4. "Whether on the facts and in the circumstances of the case and in law, the Id CIT(A) erred in not appreciating the fact that the A.O. is not required to consider the commentary on Article 13(4) of the UN model when the Article 14(4) of the DTAA is very clear in itself and the commentary on any Article comes in picture only when there is any ambiguity on the issue."

5. "Whether on the facts and in the circumstances of the case and in law, the Id CIT(A) erred in not appreciating the fact that UN Model treaty on capital gains and India-Spain treaty are not same and have different provisions and carve outs for capital gains and thus Commentary of UN Model cannot be applied to explain India-Spain treaty."

6. "Whether on the facts and in circumstances of the case and in law, the Id CIT(A) erred in not appreciating the Assessing Officer's decision in this case that the transfer of shares of realty based companies attracts Article 14(4) of the India-Spain DTAA which is very clear on this issue."

8. Learned representative have fairly agreed that whatever we had decided in ITA No. 6109/Mum/2018, which deals with identical grievance of the Assessing Officer for the Assessment Year 2013-14 and which was heard along with this appeal, will apply *mutatis mutandis* this year as well.

9. Vide our order of even date, we have dismissed similar ground of appeal, raised by the appellant Assessing Officer for the assessment year 2013-14, and while doing so, we have, *inter alia*, observed as follows:

> *28. In substance, these rather verbose grounds of appeal so raised by the appellant Assessing Officer are nothing but arguments in support of the appellant Assessing Officer's core grievance that the CIT(A) erred in holding that, on the facts and in the circumstances of the case, learned CIT(A) erred in deleting the addition of capital gain of Rs 11,31,51,216 on sale of shares of companies engaged in the real estate development activities and in not holding that such capital gains are taxable in the source jurisdiction under article 14(4) of the Indo Spanish tax treaty.*
>
> *29. This issue in appeal also lies in a rather narrow compass of undisputed material facts. During the course of scrutiny assessment proceedings, the Assessing Officer, inter alia, noted that the assessee had earned capital gains amounting to Rs*

*11,31,51,216 on sale of shares in real estate companies which were included in BSE realty index. The Assessing Officer noted that these companies were dealing in real estate sector including development of properties, residential as also commercial, and value of shares of these companies is derived from the value of immovable properties held by these companies. He was of the view that it is immaterial whether these properties are held as stock in trade or as investments. In the backdrop of this analysis, the Assessing Officer noted that under Article 14(4) of the Indo Spanish tax treaty, gains from the alienation of shares of a company the property of which consists, directly or indirectly, principally of immovable property, is to be taxed in the source jurisdiction. He thus concluded that the capital gain on sale of these shares in Indian real estate companies is taxable in India under article 14(4) of the Indo Spanish tax treaty. An addition of Rs 11,31,51,216 was, accordingly, made to the income returned by the assessee. Aggrieved, assessee carried the matter in appeal before the CIT(A). The CIT(A) noted the plea of the assessee that there is no indirect transfer of ownership of immovable properties by transfer of these shares, and that, in terms of the UN Model Convention commentary, the provisions of Article 14(4) come into play only in the cases of indirect transfer of ownership of immovable property by the transfer of shares owning these properties. He then referred and relied upon decisions of his predecessor, upholding the plea of the assessee, which stand approved by coordinate benches of this Tribunal. It was noted that while the assessee has invested in the shares of real estate companies "**but the holding of immovable property developed by them remaining unsold is in the nature of stock in trade**" and that "**the value of these shares in the stock market is based not just on the extent of the immovable property held by them as stock in trade but on several other factors such as capital adequacy, projects in the pipeline, current profits and future prospects**". It was noted that the assessee's shareholding in these companies was well under 7% and "with such miniscule shareholding, the assessee cannot be treated as having acquired any right in stock in trade of those companies" and "**the assessee had no effective right to occupy the immovable properties of those companies**". It was also noted that a purposive construction of the provision of Article 14(4) would show that it was meant to cover the cases in which indirect transfer of immovable properties, by way of transfer of shares in the companies holding such properties, and that it would not cover the cases in which commercial investments are made in the companies dealing in real estate as in the present case. The support for this approach was found in the UN Model Convention Commentary in respect of the similar provisions in the UN Model Convention. It was in this backdrop that, following the judicial precedents- including in assessee's own case, the CIT(A) concluded that the provisions of Article 14(4) would not apply to the facts of this case. The co-ordinate bench decision, relied upon by the learned CIT(A), was an exceptionally brief order which, in it's operative part, simply observed that **".......the assessee was deriving income from immovable properties. The AR supported the order of the FAA. We find that the assessee had invested in certain companies that were in the business of developing properties, that it was not holding any property directly or indirectly, that the provisions of Article 14(5)** [sic, it should have been 14(4)] **were applicable for the properties held by a Spanish Company. The FAA had given a categorical finding of fact that assessee was not holding any property in India. In our opinion, the order of the FAA does not suffer from any legal or factual infirmity. So, confirming his order, we decide the effective GOA against the AO."** As we note this finding by the coordinate bench, we must hasten to add that it has not even been the case of the Assessing Officer that any immovable properties were held by the assessee company or that the provisions of article 14(4) [not article 14(5) which has nothing to do with issue in appeal before us] would apply only in*

respect of Spanish companies holding immovable properties in India. Be that as it may, the conclusions of the coordinate bench were in favour of the assessee and that's what apparently mattered at the end of the day. The learned CIT(A) found support from the same, and, thus reversed the action of the Assessing Officer. Accordingly, the gains on sale of shares in real estate companies was held to be not taxable in India. The Assessing Officer is aggrieved and is in appeal before us.

30. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

31. As we deal with these grievances, we consider it appropriate to begin with reproducing article 14, the interpretation of which is at the core of controversy requiring our adjudication. This provision is as follows:

> ***ARTICLE 14- CAPITAL GAINS***
>
> ***1. Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.***
>
> ***2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.***
>
> ***3. Gains from the alienation of ships or aircraft operated in international traffic or of movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.***
>
> ***4. Gains from the alienation of shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed in that State.***
>
> ***5. Gains from the alienation of shares of the capital stock of a company forming part of a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.***
>
> ***6. Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.***

32. The short case of the Assessing Officer is that the gains of sale of shares in certain Indian companies, which find place in BSE realty index, are, by the virtue of article 14(), taxable in India

*33. Article 14(4) of Indo Spanish tax treaty, as reproduced above, provides that gains from the alienation of shares of a company "**the property of which consists, directly or indirectly, principally of immovable property**" situated in a treaty partner jurisdiction will be taxable in that jurisdiction. That is, one must bear in mind the fact, quite in contrast with the general principle that, except in the specified situations, capital gains can only be taxed in the residence jurisdiction. The taxation in source jurisdiction is not a rule, but rather exception to a rule.*

*34. In plain words, what it means is that in order to invoke an exception, enabling taxation of capital gains in the source jurisdiction, the **gains must arise in the hands of the Spanish company** (i.e. the assessee in this case) on (a) **on alienation of shares in other contracting state** (i.e. in India in this case); (b) **the property of such a company, shares in which are sold by the assessee, must consist of "principally" of immovable properties**; (c) **such a holding of**, principally, the **immovable properties may be direct or indirect** (i.e. through a step down subsidiary or under any other arrangement). Under article 14(4), thus, it is only on satisfaction of these conditions that the gains, in the hands of a tax resident of Spain, on alienation of shares in Indian company can be brought to tax in India.*

*35. Article 14(4), in the present case, is a provision allocating the taxing right to source jurisdiction in certain situations as an exception to the general rule of taxation of capital gains in the residence jurisdiction adopted in this tax treaty, and, it is, therefore, on the source jurisdiction to demonstrate that these conditions are satisfied. It is only elementary that no one can be expected to prove a negative, and, therefore, the onus cannot be on the assessee to demonstrate that these conditions are not satisfied. As observed by Hon'ble Supreme Court, in the case of **K P Varghese Vs ITO [(1981) 131 ITR 597 (SC)]**, "**to throw the burden of …(proving a negative)….. would be to cast an almost impossible burden**". The onus is thus clearly on the Assessing Officer to prove that the conditions of article 14(4) are satisfied was thus on the Assessing Officer.*

36. No material is brought on record to discharge the onus, so cast on the Assessing Officer, before taxation under article 14(4) is invoked. There is not even whisper of a suggestion that the Indian companies in which the assessee had invested the monies, as share capital, were "principally" holding the immovable properties. All that the Assessing Officer has pointed out is that these companies were listed on BSE realty index, and proceeded on the assumption, an unrealistic and incorrect assumption by any standard, that every company listed on BSE realty index is a company the property of which principally consists of immovable properties. What it overlooks is that the companies listed in realty index, without any dispute or controversy, are the companies are engaged in the business of real estate development rather than in the business of holding real estate as investments. The business model of realty companies is focussed on gains from real estate development rather than gains from holding the immovable properties. There is no discussion whatsoever on the scope, and relevance, of the expression "principally" appearing in article 14(4) and once again the Assessing Officer apparently proceeds on rather bizarre assumption that every such company engaged in the property development must "principally" be having immovable properties as its assets. The case of the Assessing Officer thus lacks prima facie merits and seriousness which can sustain a judicial scrutiny.

37. The above factual position apart, even on the plain legal principles and on a reasonable interpretation of tax treaty provisions, the case before us is such that it cannot, by its very nature, fall in the kind of cases visualized under article 14(4).

38. As we have noted earlier in our discussions, the rule in article 14 is for residence taxation of capital gains- subject, of course, to the exceptions set out therein. As far as capital gains relatable to immovable properties are concerned, there are only two exceptions. The first exception is that the capital gains on sale of immovable property is taxable in source jurisdiction. The second exception, which is only an extension of the first exception, is that the gains on sale of a company, property of which mainly, even if directly or indirectly, consists of the immovable properties, is also taxable in the source jurisdiction. The second exception, in a way, takes colour from the first exception. It is a widely known fact that on many occasions, the companies are floated mainly to hold the immovable properties, and the transfer of ownership in these companies is far easier, less expensive and smooth a process than the transfer of ownership of the underlying immovable properties. It was for this reason, and to effectively implement the underlying principle on which foundation of article 14(1) rests, i.e. the gains on appreciation of value of immovable properties must be taxed in the source jurisdiction, that article 14(4) has come into existence. That is what is borne out of the unmissable ground realties as also of literature on international tax treaty policy development.

39. With this backdrop in mind, we have to attempt to interpret the scope of Article 14(4). Let us, however, take note of certain ground rules of the principles of interpretation of treaties.

40. It is important to bear in mind one more aspect of the Hon'ble Supreme Court's landmark judgment, in the case of ***K.P. Varghese v. ITO [1981] 131 ITR 597 (SC)].*** *This was also the case in which Hon'ble Justice Bhagwati, in his inimitable manner, dealt with the principles governing interpretation of tax laws and observed that the task of interpretation is not a mechanical task and, Their Lordships' quoting with approval, Justice Hand's observation that "****it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning****". Their Lordships observed as follows:*

> ***"...The task of interpretation of a statutory enactment is not a mechanical task. It is more than a mere reading of mathematical formulae because few words possess the precision of mathematical symbols. It is an attempt to discover the intent of the Legislature from the language used by it and it must always be remembered that language is at best an imperfect instrument for the expression of human thought and, as pointed out by Lord Denning, it would be idle to expect every statutory provision to be 'drafted with divine prescience and perfect clarity'. We can do no better than repeat the famous words of judge Learned Hand when he said:***
>
> > ***'...it is true that the words used, even in their literal sense, are the primary and ordinarily the most reliable source of interpreting the meaning of any writing: be it a statute, a contract or anything else. But <u>it is one of the surest indexes of a mature and developed</u>***

> ***jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.'***

> ***We must not adopt a strictly literal interpretation of....but we must construe its language having regard to the object and purpose which the Legislature had in view in enacting that provision and in the context of the setting in which it occurs. We cannot ignore the context and the collection of the provisions in which... appears, because, as pointed out by judge Learned Hand in the most felicitous language interpret... the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create...."***

[Emphasis, by underlining, supplied by us now]

41. When such are the views of the Hon'ble Supreme Court on the interpretation of taxing statutes, essentially the tax treaties, which are to be subject to much less rigid rules of interpretation, cannot be subjected to literal interpretation in isolation with the context in which the words have been employed. On a similar note, Hon'ble Supreme Court, in the case of ***Union of India v. Azadi Bachao Andolan [(2003) 263 ITR 706 (SC)]****has observed that the principles adopted in the interpretation of treaties are not the same as those adopted in the interpretation of statutory legislation. Their Lordships quoted, with approval, a passage from the judgment of the Federal Court of Canada in the case of* ***N. Gladden v. Her Majesty the Queen 85 DTC 5188, at page 5190*** *wherein the emphasis is on the 'true intentions' rather than 'literal meaning of the words employed'. This quote was "****Contrary to an ordinary taxing statute, a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated insofar as the particular items under consideration are concerned****".*

42. As we deal with the principles of interpretation of tax treaties, it may also be appropriate to refer to some of the observations made by a coordinate bench, in the case of ***Hindalco Industries Ltd Vs ACIT [(2005) 94 ITD 242 (Mum)]*** *in the context of principles governing the interpretation of tax treaties. That was a case in which the coordinate bench, after an elaborate analysis of the related judicial precedents from even outside India and the related first principles, inter alia, observed that* ***"A tax treaty is to required to be interpreted as a whole, which essentially implies that the provisions of the treaty are required to be construed in harmony with each other"****, that* ***"the words employed in the tax treaties …… need not be examined in precise grammatical sense or in literal sense"*** *and* ***"even departure from plain meaning of the language is permissible whenever context so requires, to avoid the absurdities and to interpret the treaty ut res magis valeat quam pereat. i.e., in such a manner as to make it workable rather than redundant".*** *It was also observed that* ***"A literal or legalistic meaning must be avoided when the basic object of the treaty might be defeated or frustrated when the basic object of the treaty might be defeated or frustrated insofar as particular items under consideration are concerned. Words are to be understood with reference to the subject-matter, i.e., verba accopoenda sunt secundum subjectum materiam."***

Double Taxation Avoidance Agreements are international agreements entered into between States. The conclusion and interpretation of such conventions is governed by public international law, and particularly, by the Vienna Convention on the Law of Treaties of 23rd May, 1969. The rules of interpretation contained in the Vienna Convention, being customary international law, also apply to the interpretation of tax treaties. This view also finds mention in the Tribunal's order in the case of ***Modern Threads India Ltd. v. Dy. CIT [1999] 69 ITD 115 (Jp.)(TM).*** *Although India is not a signatory to Vienna Convention on Law of Treaties (VCLT), our judicial forums, right upto Hon'ble Supreme Court, have consistently referred to, and relied upon, Vienna Convention on Law of Treaties (VCLT), e.g. in the case of* ***Union of India Vs Azadi Bachao Andolan [(2003) 263 ITR 706 (SC)]****. Elaborating upon the principles governing interpretation of tax treaties, Lord Denning, in* ***Bulmer Ltd. v. S.A. Bollinger [1972] 2 AER 1226,*** *has observed that* ***".......... The treaty ...... is quite unlike any of the enactments we have been accustomed… It lays down general principles. It expresses aims and purposes ...... what are English Courts to do when they are faced with a problem of interpretation? They must follow the European pattern. No longer must they examine the words in meticulous detail. No longer must they argue about the precise grammatical sense. They must look to the purpose or intent........."*** *Echoing these views and justifying his departure from the plain meaning of the words used in the treaty, Goulding J. in* ***IRC v. Exxon Corpn. [1982] STC 356*** *at page 359, observed that* ***"In coming to the conclusion, I bear in mind that the words of the Convention are not those of a regular Parliamentary draughtsman but a text agreed on by negotiations between the two contracting Governments. Although I am thus constrained to do violence to the language of the Convention, I see no reasons to inflict a deeper wound than necessary. In other words, I prefer to depart from the plain meaning of language only in the second sentence of article XV and I accept the consequence (strange though it is) that similar words mean different things in the two sentences."***

43. Article 31(1) of the Vienna Convention States that ***"A treaty shall be interpreted in good faith in accordance with the ordinary meaning given to the terms of the treaty in their context and in the light of its object and purpose".*** *In the light of the detailed discussions above, the mandate of article 31(1) has to be borne in India while interpreting article 14(4). What was the object and purpose of Article 14(4). The question that we must, therefore, ask ourselves is as to what was the purpose and object of article 14(4).*

44. We find that the gains on alienation of immovable properties are taxable in source jurisdiction. That provision is contained in article 14(1). However, as we have also noted in our analysis earlier, rather than an assessee holding the immovable properties directly in the treaty partner jurisdiction, as a measure of convenience and expediency, many a times corporate structures are used for ownership of immovable properties in the treaty partner jurisdiction. Article 14(4) seeks to nullify the impact of such manoeuvrings so far as taxability of taxability of capital gains in the source jurisdiction is concerned. In that sense, Article 14(4) is only an extension of article 14(1), inasmuch much as whether the assessee owns the immovable property in the treaty partner jurisdiction on its own, or through a web of corporate structures, the gains on account of value appreciation on of such immovable properties must be taxed in the source jurisdiction as well. The taxation will infringe neutrality if it is to depend on the manner in which the assets are held, and that is the unambiguous object that article 14(4) seeks to achieve. This is the object, in our humble understanding, and the raison d'etre of article 14(4) being in existence.

45. The wordings in the UN Model Convention, which has obviously evolved over a long period of time, are definitely not the same as the words employed in Indo Spanish tax treaty that we are dealing with. However, the underlying principle- as discussed above, is the same, and that is what is clearly borne out of UN Model Convention Commentary.

46. The thrust of this provision is that the property of such companies, transfer of shares of which leads to taxability of gains in the source jurisdiction, consist "principally" of immovable property.

47. The common thread in the UN Model Convention Commentary and the OECD Model Convention Commentary is that the threshold to trigger this taxation on alienation of shares of a company where underlying assets constitute immovable property is of fifty percent or more of the aggregate value of assets.

48. In the OECD Model Convention, in the place of "principally", the threshold test itself is prescribed at fifty percent of the aggregate value of asset. The expression "principally" was clearly defined, until the 2017 update, in the UN Model Convention itself as such. In the 2017 update, the UN Model Convention provided for a specific minimum threshold trigger to be decided between the contracting state, but then that's an event much later to not only the Indo Spanish tax treaty but also to the relevant financial period. This interpretation of the scope of "principally" must be understood in the context of the purpose of this treaty provision.

*49. The UN Model Convention Commentary, as last updated, notes the historical background and justification for this treaty provision, by observing that "**Since it is often relatively easy to avoid taxes on such gains through the incorporation of a company to hold such property, it is necessary to tax the sale of shares in such a company. This is especially so where ownership of the shares carries the right to occupy the property**". The OECD Convention commentary, as last updated, notes that by this provision, it is ensured that "**gains from the alienation of such shares or comparable interests and gains from the alienation of the underlying immovable property**" are equally taxable in that State.*

*50. There cannot be any dispute that these model convention commentaries do not bind us, but even then these commentaries are in the nature of **contemporanea expositio** nevertheless inasmuch as the meaning and backdrop of expressions in the tax treaties can be inferred, to use the words of Lord Redcliffe, as in 'international tax language' developed by these multilateral organizations. Hon'ble Andhra Pradesh High Court, in the case of **CIT v. Vishakhapatnam Port Trust [(1983) 144 ITR 146 (AP-FC)]**, referred to the OECD Commentary on the technical expressions and the clauses in the model conventions, and referred to, with approval, Lord Redcliffe's observation in **Ostime v. Australian Mutual Provident Society [1960] 39 ITR 210, 219 (HL)** which have described the language employed in those documents as the 'international tax language'. When a provision in the treaty is materially the same as in the model tax conventions, the normal presumption is that the persons using the said provision are also aware about the meanings assigned to the same by these multilateral bodies and have used it in the same sense and for the same purpose- unless, of course, a contrary intention is specifically expressed, say by a protocol attached to the DTAA*

*51. In the light of this analysis as also the backdrop in which the related treaty provision for source taxation of company holding principally immovable property in that jurisdiction find place, when we are to interpret the scope of the expression "**shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed in that State**", it must essentially remain confined to the shares which, taken on standalone basis or as a cumulative effect of the related transactions, lead to the control of the company or, in any other way, give right to enjoy or occupy the underlying immovable property owned by the company in question and such property must be what the company in question principally holds. In our considered view, this is the only way in which we can harmonise this provision, as mandated by article 31 of VCLT, "**in the light of its object and purpose**", and, in our humble understanding, there cannot be better guidance on the intent of the object and purpose of a treaty provision than the understanding shared by the very multilateral institutions which have conceived and developed the said provision.*

52. The wordings of UN and OECD Model Convention do differ from the provision in the treaty before us, and, but then, it is not, nor can it be, revenue's case that the intent and purpose for which article 14(4) was introduced was any different.

*53. Even keeping the mandate of Article 31(1) of VCLT aside for a while, the guidance given by Hon'ble Supreme Court in the case of **K P Varghese** (supra) is worth bearing in mind when it comes to interpretation of tax laws. Hon'ble Supreme Court had, inter alia, quoting, with approval, Justice Hand that, "**it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning**". Viewed thus, we cannot ignore the clear intent of the scheme of article 14(4) and interpret the meaning thereof in isolation with its unambiguous object and purpose, and we interpret this provision in the light of the purpose and object it was to accomplish, the inevitable conclusion is that the taxability of gains on sale of shares in companies principally holding the immovable property can be taxed in the source jurisdiction when such an alienation of shares, directly or indirectly and on standalone basis or in conjunction with other transactions, results in the control and enjoyment, of the underlying property, changing hands too.*

54. The manner in which the interpretation is sought to be assigned will result in a situation that, as a rule, the gains on alienation of shares, even as an investor simplictor, in companies engaged in realty business will become taxable in the source jurisdiction, and these companies, as a business model, aim at the commercial gains in the development of real estate rather than holding the immovable properties. Does it fit in the scheme of Article 14? The answer is certainly in negative. The investments in shares of the companies, engaged in the realty business, cannot be, in principle, treated any differently for taxability purposes. In any event, neither it was so intended nor there is any indication or justification for the same. The scheme of Article 14, as we have analysed earlier as well, has its fundamental principle that, as a rule, capital gains are taxable only in residence jurisdiction, and the exceptions are when the gains relate to immoveable property, when gains relate to assets of the permanent establishment or fixed place of business- as the case may be, or when gains relate to alienation of shares in a company forming part of a participation of at least 10 per cent in a company which is a fiscally domiciled in a jurisdiction. In all these cases, common thread is substantial presence and control, by the assessee, in the taxation jurisdiction.

The alienation of shares in a realty company does not belong to the genus of these provisions. There is no other conceptual justification for the same. Quite to the contrary, as the scheme of the treaty clearly shows, the justification for this treaty provision is entirely different- as we have discussed above. If we are to do by the interpretation as canvassed before us by the revenue, it will result in a situation in which the gains on sale of shares, held as an investor in the company rather than a de facto investor in the immovable property, with the intent of enjoying or controlling the underlying immovable properties, in companies owning immovable property will become taxable in the source state. That position does not fit in the scheme of the treaty provisions under article 14, and is clearly an incongruous result.

55. In the present case, while the assessee has sold no more than 2% shares in any of the six realty companies, namely Anant Raj Limited, DLF Limited, Indiabulls Real Estate Limited, Mahindra Lifespace Developers Ltd, Shobha Developers Ltd and Unitech Limited, as an investor. There is no question of holding any controlling interest or even significant interest in these companies. These holdings therefore cannot give, or be even part of an effort to get, controlling right or any other right to occupy the property. It has not even be the case of the Assessing Officer that the assessee had significant holdings in these companies. That apart, it is also important to note that all these companies are engaged in the business of real estate development rather than in the business of holding real estate as investments. The business model of realty companies is focussed on gains from real estate development rather than gains from holding the immovable properties. Viewed in the context of the purpose for which article 14(4) finds place in the Indo Spanish tax treaty, and unambiguous thrust of such provisions in the tax treaty literature, article 14(4) is to be read alongwith and to supplement article 14(1), the gains on sale of such shares cannot indeed be taxed in the source state under article 14(4).

56. Secondly, while the expression 'principally' is not specifically defined in the Indo Spanish tax treaty, as evident from the subsequent clarifications in the model convention commentaries, and in the absence of anything to suggest there was a different intention at an earlier point of time, the threshold test can be safely applied at "fifty percent" of total assets.

57. What essentially follows that the sale of shares in only such companies are covered as hold, directly or indirectly, at least fifty percent of the aggregate assets consisting of immovable property. Just because a company is dealing in real estate development does not imply, or even suggest, that over fifty percent of its aggregate assets consist of immovable properties. It is not the case before us that predominant part, or fifty percent, of aggregate of assets of these companies consist of immovable properties. The Assessing Officer has made no efforts whatsoever to demonstrate, or even indicate, that the assets held by these companies constituted "principally" the immovable properties. The Assessing Officer has apparently proceeded on the presumption that just because these companies are dealing in real estate development, the assets of these companies "principally" consist of immovable properties. Such an approach cannot get any judicial approval.

58. In the light of these discussions, and for all these reasons taken together, we approve the conclusions arrived at by the learned CIT(A) on this point as well and decline to interfere in the matter. On this issue also, our reasoning is different than the reasoning adopted by the coordinate bench, but then our conclusions are the same. These are the conclusions which ultimately matter to the taxpayer but then, form our

perspective, no matter what we decide, it is subject to judicial scrutiny by Hon'ble Courts above, and it is our duty to facilitate that process by setting out our clear reasons for coming to these conclusions.

10. We see no reason to take a different view than the view taken by us for the assessment year 2013-14. Respectively following the same, we reject the grievance raised by the Assessing Officer and confirm the confusion arrived at by the learned CIT(A). There is, thus, no interference in the matter.

11. Ground Nos. 2 to 6 are also, therefore, dismissed.

12. In the result, the appeal is dismissed. Pronounced in the open court today on the 11th day of October, 2019

Sd/xx
Saktijit Dey
(Judicial Member)

Sd/xx
Pramod Kumar
(Vice-President)

Mumbai, dated the 11th day of October, 2019

Copies to:	*(1)*	*The appellant*	*(2)*	*The respondent*
	(3)	*CIT*	*(4)*	*CIT(A)*
	(5)	*DR*	*(6)*	*Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai