IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'D' : NEW DELHI

BEFORE SHRI G.S. PANNU, VICE PRESIDENT AND
SHRI KUL BHARAT, JUDICIAL MEMBER

ITA No.528/Del/2022
Assessment Year : 2018-19

M/s Corning SAS India Branch Office, 2nd Floor, Pioneer Square, Sector-62, CRPF Road, Near Golf Course Extension Road, Gurgaon, Haryana – 122 005. PAN : AAACC3889Q.	Vs.	Deputy/Assistant Commissioner of Income Tax, International Tax, Gurgaon.
(Appellant)		(Respondent)

Appellant by : Shri Rajan Vora, CA.
Respondent by : Shri Bhuvnesh Kulshresth, CIT-DR &
Shri Om Prakash, Senior DR.

Date of hearing : 12.01.2024
Date of pronouncement : 06.02.2024

ORDER

PER G.S. PANNU, VP :

This appeal by the assessee for the assessment year 2018-19 is directed against the order of Assessing Officer dated 29th January, 2022 passed under Section 143(3) read with Section 144C(13) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act').

2. The assessee has raised the following Grounds of appeal :-

"In the facts and circumstances of the case and in law, the learned Assessing Officer and the Hon'ble DRP has:

1. erred in holding that interest on income tax refund pertaining to AY 001-02 and AY 2003-04 received in current year shall be taxable as business income under Article 7 of India-France DTAA as against offered to tax as interest income amounting to INR 1,79,47,179 under Article 12 of India-France DTAA;

2. erred in holding that the branch office in India would constitute a Permanent Establishment (PE') of Corning SAS in India for current year disregarding the fact that no business was being carried out from the aforesaid branch post 1 February 2012 and thereby wrongly held the branch office as PE;

3. erred in concluding that interest income is liable to taxed as business income under Article 7 of India-France DTAA by treating branch office as PE in India, without appreciating that even if it is held that assessee has PE in India (without admitting) the said interest income would still not be chargeable to tax as business income as the same is not effectively connected to alleged PE;

4. without prejudice to our contention that assessee does not have a PE in India in relevant AY and income cannot be considered as effectively connected to PE, in case it is held that income is taxable as business income under Article 7, then the business expenditure incurred during the year should be allowed to be adjusted against the said business income;

5. erred in law and in fact, in proposing to initiate penalty proceedings under section 270(A) of the Act."

3. During the course of hearing, the assessee has also filed following Additional Grounds of appeal :-

"Additional grounds of appeal

Validity of proceedings under section 143(3) r.w.s 144C of the Act

6. erred in upholding the order of the learned Assessing Officer without appreciating the fact that in absence of any variation proposed to the income of the Appellant, which is prejudicial to the interest of the

Appellant, passed an order under section 143(3) read with section 144C(1) of the Income-tax Act, 1961 instead of directly issuing a final assessment order under section 143(3) of the Act and thus, the final assessment order issued should be quashed and treated as non-est given that time period prescribed under section 153 of the Act read with CBDT Notifications for passing the final assessment order has lapsed.

Non-Taxability of interest on income tax refund by application of MFN clause in India- France DTAA

7. erred in not appreciating that no tax should be levied on interest earned on income tax refund received by the Appellant, being a tax resident of France, by application of the Most Favoured Nation ('MFN') clause contained in India-France Double Taxation Avoidance Agreement ('DTAA') read with the restricted scope of taxation of 'Interest' under Article 12 of the India-Italy DTAA, wherein any interest received from government is not taxable."

4. Although the appellant-assessee has raised multiple grounds of appeal but, in sum and substance, the solitary dispute revolves around the rate at which the income returned by the assessee of ₹1,79,47,173/- representing interest on income tax refund is liable to be taxed. At the time of hearing, the singular point which has been argued before us is manifested by way of Ground of appeal No.3. In order to understand the controversy and the rival stands thereof, the following discussion is relevant.

5. The appellant before us is incorporated in France and is, *inter alia*, engaged in the sale of ophthalmic and life science products in the Indian market. It has India branch office which was established in 1997. The assessee transferred its entire business operations in India to a group company with effect from 1st February, 2012 and, therefore, for the assessment year under consideration, i.e. 2018-19, the India branch office had no business activity. It transpires that during the

assessment years 2001-02 and 2003-04 when India branch office was doing business, assessee paid excess income-tax on its business profits and, accordingly, a refund was due to it. During the assessment year under consideration before us, the assessee received interest from the Income-tax Department on such income tax refund amounting to ₹1,79,47,179/-. In the return of income filed on 30th October, 2018, the assessee offered the aforesaid income to tax in India in terms of Paragraph 2 of Article 12 of the DTAA between India and France at the rate of 10%. At the stage of the draft assessment order under Section 144C of the Act dated 12th April, 2021, the Assessing Officer sought to tax the said interest income at the rate of 40%, thereby treating it as business income, as against the stand of the assessee of treating the said income as interest income in terms of Article 12 of the India-France DTAA. In coming to such conclusion, the Assessing Officer treated the branch office in India as being equivalent to a PE of the assessee and also held that such interest income was effectively connected with the PE in India. In other words, the Assessing Officer concluded that the interest income in question was business income which was to be taxed in terms of Article 7 read with Paragraph 5 of Article 12 of the India-France DTAA. The DRP, in its directions dated 6th December, 2021, affirmed the findings of the Assessing Officer and, *inter alia*, observed that merely because the interest on the income tax refund was received after the closure of the India branch office would not change the character of such receipt and that it was to be treated and taxed as business income. The Assessing Officer has thereafter passed the final assessment order under Section 143(3) read with Section 144C(13) dated 29th January, 2022 on the above lines, against which, the assessee is in further appeal before us.

6. The short point, manifested by way of Ground of appeal No.3 enumerated above is to the effect that even if it is assumed that assessee has a PE in India in the form of India branch office, but since

the said PE has not been carrying out any business activity in India since February, 2012, the income in question, i.e., 'interest on income-tax refund' cannot be said to be "*effectively connected with such permanent establishment*", and, therefore, it does not fall in the ambit of Paragraph 5 of Article 12 so as to be taxed as business profits in terms of Article 7 of India France DTAA; and, that the same is directly covered by Paragraph 2 of Article 12 of India-France DTAA so as to invite taxation at the rate of 10%. At the time of hearing, the learned Representative contended that the aforesaid aspect was succinctly brought out before the Assessing Officer at the stage of draft assessment order as well as during the proceedings before the DRP. In support of the above proposition, reliance has been placed on the following decisions :-

(i) ACIT v. Clough Engineering Ltd (130 ITD 137) (Delhi Tribunal-SB).

(ii) Clough Engineering Ltd v. ACIT (ITA No. 4771 and 4986/Del/2007 dated 13 April 2017) / [2017] 83 taxmann.com 170 (Delhi Tribunal).

(iii) Aker Solutions India SDN BHD v. DCIT (ITA No. 1004/Mum/2022 dated 7 November 2022) (Mumbai ITAT).

(iv) MSC Mediterranean Shipping Company, S.A. v. DDIT(IT) (2015) 154 ITD 478 (Mumbai Tribunal) - Approved by Hon'ble Bombay HC (ITA No. 896 of 2016 dated 14 January 2019).

(v) DHL Operations BV v. DDIT (ITA No. 183/Mum/2010 dated 21 September 2011) (Mumbai Tribunal) - Appeal filed by Revenue dismissed by Hon'ble Bombay HC (ITA No. 431 of 2012 dated 17 July 2014).

(vi) DIT(IT) v. Credit Agricole Indosuez [2015] 377 ITR 102 (Bom HC).

(vii) International Global Networks BV v. DDIT (2012) (50 SOT 433) (Mumbai Tribunal) - Issue not challenged by the department before the Hon'ble Bombay HC (ITA No. 1579 of 2012 dated 12 December 2014).

(viii) Transocean Offshore International Ventures Ltd v. DCIT(IT) (ITA No. 5895/Del/2017 dated 28 January 2022) (Delhi Tribunal).

(ix) ACIT(IT) v. Baker Hughes Singapore Pte (ITA No. 5337/Del/2018 dated 8 February 2022) (Dehradun Tribunal).

7. On the other hand, the learned DR appearing for the Revenue has primarily reiterated the stand of the Assessing Officer inasmuch as, according to him, the interest on income tax refund is connected to the business income, having arisen from business activities, and as the assessee has a PE in India, the same is to be taxed as business income under Article 7 of the India-France DTAA. According to the learned DR, the interest income having arisen from business activities can be understood to be 'connected to PE' also and, therefore, the Assessing Officer made no mistake in treating the said sum to be covered by the exception provided in Paragraph 5 of Article 11, thereby liable to be taxed as 'business income' under Article 7 of the India-France DTAA.

8. We have carefully considered the rival submissions. Insofar as the fact position is concerned, there is no dispute that the assessee is a branch office of a French entity in India and also that during the year under consideration, the India branch office has not carried out any business activity. This aspect has been consistently canvassed by the assessee before the lower authorities, without any repudiation; and, in any case, it is supported by the fact that the solitary income declared by the assessee for the year under consideration is of ₹1,79,47,179/- representing interest on the income tax refund. Our attention was also invited to the audited financial statements for the year under

consideration, a copy of which has been placed in the Paper Book at pages 73 to 89.

9. Though, it is the stated position of the assessee that the India branch office cannot be treated as its PE in India, yet, for the limited purpose of supporting Ground of appeal No.3, the learned Representative submitted that without prejudice to the stand that it does not have a PE in India, even if it is considered that the assessee has a PE in India, the interest income earned by the assessee cannot be taxed in India considering that it is not effectively connected with the PE; and, thus it cannot be taxed under Article 7 but is to be taxed under Article 12 of India-France DTAA. In order to examine the aforesaid, we may peruse Article 12 of the India France DTAA, the relevant portion of which reads as under :-

> *"1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State.*
>
> *2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the recipient is the beneficial owner of the interest, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.*
>
> *.....*
>
> *5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other Contracting State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 15, as the case may be, shall apply."*

10. Shorn of other details, for the purposes of appreciating the limited controversy before us, it is relevant to note that in terms of Paragraph 1 of Article 12, interest arising in a contracting State and paid to a resident in other contracting State may be taxed in the other State. Paragraph 2 provides an exception and prescribes that such interest may also be taxed in the contracting State in which it arises but, if the recipient is the beneficial owner of the interest, the tax so charged shall not exceed 10% of the gross amount of such income. Paragraph 5 of Article 12 enumerates that the provisions of Paragraph 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a contracting State, carries on business in the other contracting State in which the interest arises through a PE situated therein or performs in that other State independent personal services from a fixed base situated therein and the debt claimed in respect of which the interest is paid is "*effectively connected with such Permanent Establishment*" or the fixed base. Paragraph 5 further states that in case of such exceptions, the provisions of Article 7 or Article 15, as the case may be, shall apply. Thus, Paragraph 5 carves out an exception whereby in certain situations interest income can be taxed as business income in terms of Article 7 or as Independent Personal Services in terms of Article 15.

11. The case of the appellant before us is that interest received by the assessee on income tax refund is not business income, inasmuch as, it is not "*effectively connected with such Permanent Establishment*" so as to attract Paragraph 5 of Article 12. The phraseology of Article 12 shows that in order to test the case set-up by the Revenue for taxing the impugned amount as per Article 7, it is not sufficient that the assessee has a PE in India and/or that the impugned sum is business income, but another critical aspect which has to be examined is as to whether the income in question i.e., interest on income tax refund is effectively connected with such PE so as to fall within the

scope of Paragraph 5 of Article 12, and thus be taxable as business income in terms of Article 7 of India-France DTAA. The learned Special Bench of the Tribunal in the case of Clough Engineering Ltd. (supra) noted in similar circumstances that the real test to be applied is not whether the interest is business income or not, but as to whether the debt-claim in respect of which the interest is paid is effectively connected with the PE or not. The case before the learned Special Bench was as to whether the interest earned on the income tax refund of tax deducted at source on business receipts could fulfill the test of being '*effectively connected with such PE or not*'. In this context, the relevant discussion is contained in Paragraph 11.4 of the judgment, which reads as under :-

> "*11.4 Thus, we are again left with the fundamental question as to whether the debt-claim in this case can be said to be effectively connected with the PE. We have already held that the claim is connected with the PE in the sense that it has arisen on account of tax deduction at source from the receipts of the PE. However, it is also a fact that payment of tax is the responsibility of the foreign company. The same is determined after computation of its income and the tax forms not an expenditure for earning the income but an item of appropriation of profit. Therefore, even if the debt is connected with the receipts of the PE, it cannot be said to be effectively connected with such receipts because the responsibility to pay the tax lies on the shoulders of the assessee-company from the final profit ascertained as on the last date of the previous year and on closing the books of account. It is for the company to pay the tax from any source available with it. It so happened in this case that the tax got automatically deducted from the receipts of the PE by operation of law. Such collection of tax by force of law would not establish effective connection of the indebtedness with the PE as ultimately it is only the appropriation of profit of the assessee company. However, we may add that we do not venture to say that the interest income has to be necessarily business income in nature for establishing the effective connection with the PE because that would render provision contained in paragraph 4 of Article XI redundant. Thus, there may be cases where interest may be taxable under the Act under the residuary*

head and yet be effectively connected with the PE. The bank interest in this case is an example of effective connection between the PE and the income as the indebtedness is closely connected with the funds of the PE. However, the same cannot be said in respect of interest on income-tax refund. Such interest is not effectively connected with PE either on the basis of asset-test or activity-test. Accordingly, it is held that this part of interest is taxable under paragraph No. 2 of Article XI. Thus, the ground referred to the Special Bench is partly allowed. The Division Bench shall dispose off the appeal in conformity with this order."

(emphasis by underlining provided by us)

12. In our considered opinion, the aforesaid decision of the learned Special Bench answers the extant controversy quite squarely inasmuch as it cannot be said that interest on income tax refund is effectively connected with the PE either on the basis of the asset-test or the activity-test, especially when there is no dispute to the position before us that India branch office of the assessee has not carried out any business activity during the previous year relevant to the assessment year under consideration. Therefore, the provisions of Paragraph 2 of Article 12 of the India-France DTAA are clearly attracted and, there is no scope for considering the instant case in terms of Paragraph 5 of Article 12 so as to invite taxability in terms of Article 7 of the DTAA. In fact, we find that in the context of India-France DTAA, the Mumbai Bench of the Tribunal in the case of Aker Solutions India SDN BHD Vs. DCIT – ITA No.1004/Mum/2022, relying upon the decision of the Special Bench in the case of Clough Engineering Ltd. (supra), had taken a similar view with respect to the interest on income tax refund received under Section 244A of the Act. On an appeal filed by the Revenue, the Hon'ble Bombay High Court in the case of DIT Vs. Credit Agricole Indosuez – 377 ITR 102 (Bom) did not find it expedient to interfere with the aforesaid decision of the Tribunal, and, thus, the same stands affirmed.

13. In view of the aforesaid, we find that the case of the assessee for taxing the income by way of interest on tax refund at the rate of 10% in terms of Paragraph 2 of Article 10 of the India France DTAA is liable to be upheld. We hold so.

14. Before parting, we may make it clear that all other Grounds, which we have enumerated in Paragraphs 2 and 3 above are not being adjudicated and, as the same have been rendered academic, because the assessee has succeeded, as above.

15. Resultantly, the appeal of the assessee is allowed as above.

Decision pronounced in the open Court on 6th February, 2024.

Sd/-	Sd/-
(KUL BHARAT)	**(G.S. PANNU)**
JUDICIAL MEMBER	**VICE PRESIDENT**

VK.

Copy forwarded to: -

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

Assistant Registrar