INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "D": NEW DELHI

BEFORE
SHRI G.D. AGRAWAL, HON'BLE PRESIDENT
AND
SHRI AMIT SHUKLA, JUDICIAL MEMBER

ITA No.:- 1388/Del/2012
Assessment Year: 1998-99

DDIT Intl. Taxation, Circle-2(2) New Delhi.	Vs.	Unocol Bharat Ltd. C/o S.R. Batliboi & Co. 6th Floor, Hindustan Tiems Building, 18-20, K.G. Marg, New Delhi.
(Appellant)		**(Respondent)**

Respondent by:	Shri G.K. Dhall, CIT(DR)
Appellant by :	Shri Nageshwar Rao, Ms. Sherry Goyal, Adv.
Date of Hearing	11/07/2018
Date of pronouncement	05/10/2018

O R D E R

PER AMIT SHUKLA, J.M.

The aforesaid appeal has been filed by the assessee against impugned order dated 11.2.2011, passed by Ld. CIT (Appeals) -29 New Delhi for the quantum of assessment passed u/s 143(3) for the assessment year 198-99. The revenue has raised following grounds: -

1. *"Whether on the facts and circumstances of the case the CIT(A) has erred in deleting the addition of Rs. 4,57,82,240/- by holding that in the absence of any restrictive clause in Article 7 of Indo-Mauritius DTTA no disallowance could be made for non deduction of TDS on salary paid to employee(s) and that section 40(a)(i) has no application, ignoring the convention in Treaty Interpretation that in absence of a specific provision, domestic law of contracting State would apply.*
2. *Whether on the facts and circumstances of the case, the CIT(A) has erred in deleting the addition of Rs. 3,33,018610 by holding that in the absence of any restrictive clause in Article 7 of Indo-Mauritius DTTA no disallowance could be made for non deduction of TDS out of operating Contract expenses and that section 40(a)(i) has no application, ignoring the convention in Treaty interpretation that in absence of a specific provision, domestic law of contracting state would apply.*
3. *Whether on the facts and circumstances of the case, teh CIT(A) has erred in deleting the additions by holding that in the absence of any restrictive clause in Article 7 of Indo-Mauritius DTTA no disallowance could be made for non deduction of TDS and that section 40(a)(i) has no application, ignoring that most Commentaries on Model tax Conventions sate that "since modern commerce organizes itself in an infinite variety of ways, it would be quite impossible within the narrow limits of an article in a double taxation convention to specify an exhaustive set of rules for dealing with every kind of problem that may arise" hence the convention in Treaty interpretation that in absence of a specific provision, domestic law of contracting State would apply.*
4. *Whether on the facts and circumstances of the case the CIT(A) has erred in not appreciating that the provisions of the Income Tax Act, 1961 are to be read in conjunction with the provisions of Indo-Mauritius DTTA for their proper application and in the absence of any specific provision in the DTTA the domestic law would apply as per convention in treaty interpretation.*
5. *Whether on the facts and circumstances of teh case, the CIT(A) has erred in deleting the addition of Rs. 5,51,65,341/- out of travel and entertainment expenses by admitting additional*

evidence in violation of Rule 46A of the Income Tax Rules 1961, without affording an opportunity to the AO to examine the genuineness and admissibility of the evidence adduced.

6. *Whether on the facts and circumstances of the case the order of the CIT(A) is perverse and liable to be quashed."*

2. Brief facts are that the assessee company is incorporated in Mauritius and is wholly owned subsidiary of Unocal Corporation USA. The assessee company in India is engaged in pursuing opportunities in the exploration, development and production of crude oil and natural oil and gas, developing power plants, pipelines, liquefied natural gas terminals and fertilizer plant in India. More specifically it was into identification of potential business opportunities in the energy sector in India. The parent company, Unocal Corporation had incorporated the assessee company as the vehicle for business development and business promotion in India. During the year, the assessee has pursued for contract of at least 21 projects in India. In the return of income, the assessee has claimed loss of Rs. 14,28,64,980/- which was claimed for credit forward to the subsequent assessment years. As noted by the AO assessee has not derived any income from any project in India and despite incurring all such expenditure it was not able to earn any income from India, even in the subsequent year also. AO on perusal of the statement of expenditure filed alongwith the return of income noted following expenses: -

- Firstly, employee cost amounting to U.S. $ 11,63,758;
- Secondly, travel and entertainment expenses US $ 14,02,271/-;
- Lastly, operating contract expenses amounting to US $ 10,65,516/-.

The AO on the employee cost noted that the assessee could not furnish the details of names and address of the employees, duration of

the stay of each employee in India and whether TDS has been deducted on salary paid to the said employees. Only the names and amount paid was submitted. In absence of details like whether TDS was deducted on the payment of salary or whether these employees were filed their income tax in India or not, AO held that the entire employee cost cannot be allowed and after invoking the provision of section 40(a)(i), he disallowed the sums amounting to Rs. 4,57,82,240/- (USD 1163,758 @ conversion rate of 39.34).

3. Similarly, with regard to cost relating to travel and entertainment, the AO noted that the assessee was requested to produce the vouchers and bills of expenditure incurred ProjectWise as it was claimed by the assessee that such expenditure has been incurred in as many as 21 projects. However, as noted by him the assessee could only submit copy of ledger account and vouchers and the vouchers and the copy of ledger account do not indicate, whether the expenses were relatable to the business of assessee or whether the same were incurred wholly and exclusively for the purpose of business. In absence of any evidence, he disallowed the expenditure aggregating to Rs. 5,51,65,341/- (USD 14,02,271).

4. Lastly, with regard to operating contract cost AO noted that assessee has not withheld any tax on such payment made to the non-residents and accordingly, he held that in view of the judgment of the Hon'ble Supreme Court in the case of Transmission Corporation vs. CIT, 239 ITR 587 (SC), such an expenditure cannot be allowed and again he invoked the provision of section 40 (a)(i) to make the disallowance. Accordingly, disallowance of Rs. 3,33,01,861/- (USD 8,46,514) was made.

5. Before the Ld. CIT(A) assessee submitted that, before the AO assessee had filed names of each 11 employees vide letter dated 13th

February, 2001 providing the amount of salary paid and vide letter dated 20.2.2001 duration of stay of each employee in India was given. These details contained all the information, viz. name of the employee, amount paid, number of days spent in India and time spent in India during the year. As per the details, the employees had spent 17% of their total time in India. The assessee also contended that in terms of Article 15 of the India-US DTAA (as the employees were of US entity) the employees could be taxed in India only if they have stayed in India for a period of 183 days or more in India. Since, this criterion was not fulfilled the assessee was not liable to deduct tax on such salary payments. It was further submitted that under India Mauritius DTAA provision of Article 7(3) are differently worded in comparison to treaties with other countries wherein additional restriction has been put on deduction of expenses which shall be allowed subject to the limitation of the tax law of that state. Under the India Mauritius DTAA no such restriction has been put for the claim of expenses under Article 7(3). In support, reliance was placed on the judgment of JCIT vs. State Bank of Mauritius Limited 2009 TIOL 712. Ld. CIT(A) in so far as the disallowance of employee cost on the ground that no TDS has been deducted by invoking the provision of section 40(a)(i), held that, Article 7(3) of the DTAA does not put any restriction of claim of expenses and accordingly, the expenditure is to be allowed when the same has been incurred for the purpose of the business of PE and no restriction has been provided in the Article and thus, no disallowance could be made on the ground that no deduction of tax at source from salary paid to such employees and provision of section 40(a)(i) cannot be invoked.

6. With regard to disallowance of travel and entertainment cost, Ld. CIT(A) held that during the course of the assessment proceedings the assessee had submitted the expenses reimbursement claim forms with

all supporting documents like name of the employee, details of the Indian project for which the expenses have been incurred, amount incurred and other relevant information. The assessee has also submitted the copy of ledger account with all the supporting documents for verification before the AO including the ProjectWise break up for expenses. He held that the stand taken by the AO that assessee has failed to substantiate its claim is not tenable at all in wake of evidences filed before him. Once these details were submitted it was the onus of the AO to rebut the same and without pointing out any error or omission in the details by the AO, he held that such an addition cannot be sustained and accordingly the same has been deleted. Lastly, with regard to the amount paid to various parties for rendering of services by invoking 40(a)(i), assessee has submitted that u/s 195 (2), if the amount paid to the non-resident whose income is not chargeable to tax in India, then no tax is required to be deducted u/s 195. Reliance was placed by him on the judgment of Hon'ble Supreme Court in the case of **GE India Technology Centre Pvt. Ltd. vs CIT, 327 ITR 456**. He further held that, since provision of section 40(a)(i) has no application in the context of India-Mauritius DTAA, the same cannot be disallowed by the AO by invoking such provision.

7. Before us, Ld. CIT DR submitted that the specific reason given by the AO for making disallowance was that the assessee could not substantiate, whether these expenses were related to the business of the PE or were incurred wholly and exclusively for the purpose of business. The expense sheets belong to the Unocal Corporation US and not to the assessee. Ld. CIT(A) has wrongly held that assessee has furnished the requisite details because assessee could not establish that the details furnished prima facie proves that the expenses were incurred for the purpose of the business. The expenses incurred by the assessee in particular facts did not belong to the company but has

not been remunerated for the activities carried out in India. Since assessee does not carry any business of its own, therefore, there is no question of allowing any expenditure while computing the income of the PE. DTAA does not provide for allowing all the expenses and it is incumbent on the assessee to show that there was an income which arose from a PE situated in India and certain expenses were incurred for the purpose of business of the PE. He further submitted that Ld. CIT(A) had admitted additional evidences in the form of letter dated 17.4.2001 which is after the date of assessment order and hence is in violation of Rule 46A.

8. On the other hand, Ld. Counsel for the assessee Shri Nageshwar Rao drew our attention to various documents placed in the paper book and submitted that all the entire details which have been appreciated by the Ld. CIT(A) was filed before the AO also, which is evident from submission dated 5th March, 2001 filed before the AO. He also drew our attention to pages 42 to 48 wherein expenditure details in relation to the various projects which were submitted before the AO. The main reasoning for disallowing the expenditure towards the salary by the AO was that, firstly, the persons receiving the salary have not filed their income tax return in India; and secondly, TDS has not been deducted on such payments. In this regard it was also brought on record that employees have spent only portion of their time and efforts of the activities and only such portion of the salary was claimed as expenditure for the purpose of determining the profits in India. The basis for disallowing is invoking of section 40(a)(i) which under the terms of article 7 (3) of India and Mauritius DTAA could not have been made, specifically when there is no provision for restriction of the allowing of expenditure as per domestic law. He also relied upon the judgment of ITAT Mumbai Bench in the case of **M/s State Bank of Mauritius Limited vs. DDIT in ITA No. 2254/Mum/2005 order**

dated 3.10.2012. The Tribunal held that there is no restriction on the allowability of expenses subject to the limitations of the taxation laws of India in Article 7 (3) of India Mauritius DTAA. In so far as allegation of violation of Rule 46A, he pointed that no additional evidence was filed during the course of the appellate proceedings and therefore, there is no error in the order of the Ld. CIT(A).

9. We have heard the rival submissions, perused the relevant finding given in the impugned order as well as the material referred to before us. Assessee company is a tax resident of Mauritius and is subsidiary of Unocol Corporation USA. The assessee had pursued contract for various projects in India for exploring business possibilities in the field of energy sector. Admittedly the benefit of India Mauritius DTAA has to be given to the assessee while computing its income in India through its PE. The assessee company has PE in terms of Article 5 in India is not in dispute and therefore, all its income and expenditure thereof has to be seen in terms of Article 7 of India Mauritius DTAA. In so far as the disallowance of salary paid to the employees, one of the main arguments of the assessee before the authorities below has been that if employee has spent only a part of their time in India and is staying in India was much less than period of 180 days. Even if the employees were sent by the US AE, then also in terms of Article 15 of India US DTAA, the employees could not tax in India, because they have stayed in India for a period of less than 183 days. This fact is evident from the details appearing at page 27 of the paper book which as under: -

Sl No.	Name of Employee	Amount (US$)	Number of days spent in India	Time spent in India in a year
1.	Arun Metre	145.875	144	39%
2.	Ing sye Tsai	79.187	48	13%
3.	Rachmat Abdoellah	110.936	46	13%

4.	Larry Grundmann	103.820	95	26%
5.	Rajendra Upadhyay	119.024	102	28%
6.	Dave Courtis	102,687	37	10%
7.	Michael Glen	54,238	53	15%
8.	Soumitra Sen	47,569	0	0%
9.	Rex Bigler	56,424	43	12%
10.	Lynn Berry	24,949	13	4%
11.	Neeraj Nityanand	51,230	107	29%
12.	Other Employees	267,822		
	Total	1,163,758	Average	17%

10. Ld. AO has made the disallowance after invoking the provision of section 40(a)(i) on the ground that no TDS has been deducted on the salary paid to the employees. First of all, from the perusal of the letter filed before the AO dated 20th February, 2001 (copy placed at page 49 of the paper book alongwith the enclosures thereto), we find that assessee has given duration of the stay of each employee in India and vide earlier letter dated 13th February, 2001 the details of names of each of 11 employees and their exact amount paid has been provided. Thus, the allegation of the AO that the details and the duration of the employees in India has not been given is not correct. In so far as invoking the provision of section 40(a)(i) to make disallowance, we agree with the reasoning given by the Ld. CIT(A) that in terms of Article 7(3) of Indo Mauritius DTAA the restriction provided under the Income Tax Act cannot be read into the treaty. The relevant Article 7(3) of India Mauritius DTAA reads as under: -

> *"3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred,*

whether in the State in which the permanent establishment is situated or elsewhere."

11. Para 3 of Article 7 provides the determination of profits of PE by allowing the deduction of expenses which are incurred for the purpose of business of the PE including executive and general administrative expenses so incurred in which the PE is situated. Accordingly, all the expenses incurred for the purpose of the business of the PE are to be allowed. There is no restriction on the allowability of such expenses subject to any limitation of the taxation laws of the contracting state (India). The phraseology used in Article 7 (3) is different from other treaties, for instance Article 7(3) of Indo US Treaty DTAA provides that deduction of expenses which are incurred for the purpose of business of the PE would be in accordance with provisions subject to the limitation of the taxation laws of that State. Similar phraseology has been used in India UAE DTAA after the protocol. Once in a treaty no such restriction has been provided for applying the limitation of the domestic taxation laws, then such limitation given under the Indian Income Tax cannot be imported in such an Article. If the expenditure has been incurred on the payment of salary or reimbursement of salary of the employees, then same has to be allowed while computing the profit and loss of the PE in full and without any restriction of deductibility as per the provision of Income Tax Act. This issue has been extensively dealt by the ITAT Mumbai Bench in the case of State Bank of Mauritius Limited in ITA No. 2254/Mum/2005, wherein the Tribunal has threadbare analysed article 7 (3) of Indo Mauritius DTAA and the phraseology used in other treaties wherein limitation of taxation in the contracting state has been specifically provided. Thus, we do not find any infirmity in the order of the Ld. CIT(A) that restriction in allowing the expenditure invoking provision of section 40(a)(i) of the Income Tax Act cannot be

read Indo Mauritius DTAA and accordingly, disallowance by invoking the provision of section 40(a)(i) cannot be made. Hence disallowance of salary paid to the employees has rightly been deleted by the Ld. CIT(A). Consequently ground No. 1 as raised by the revenue is dismissed.

12. In so far as the deletion of operating contract expenditure with the payment made to the non resident on the ground that TDS has not been deducted and therefore same are to be disallowed u/s 40(a)(i), we find that, *firstly*, nowhere it has been brought on record that the payment made to these non-residents were income in the hands of such non-residents which is to be taxed in terms of section 195(2); *secondly*, the provision of section 40(a)(i) cannot be invoked while allowing the expenditure in terms of Article 7(3) in Indo Mauritius DTAA as held in the earlier part of the order. Thus, there is no infirmity in the order of the Ld. CIT(A) while deleting the said disallowance.

13. Lastly, coming to the issue of disallowance of expenditure relating to travel and entertainment, first of all from the perusal of the replies filed before the AO, we find that assessee vide letter dated 5th March, 2001 has filed a copy of ledger account for travel and entertainment providing details of the expenditure incurred under this head and also filed vouchers and bills against the expenditure incurred for verification before the AO. These details are appearing from pages 45 to 48 of the paper book which has been filed alongwith the reply before the AO. Assessee has also given ProjectWise break up of expenditure which included the travel and entertainment vide letter dated 13th February, 2001. Now once these details were furnished before the stage of the AO itself, then to hold that these expenditure were not incurred for the purpose of the business would be too

farfetched, because incurring of travelling and entertainment expenditure for various projects at the outset cannot be held to be non business purpose. Once AO has not disputed the fact that assessee has been carrying out its various activities through various projects in India, then any such expenditure relating to the project cannot be disallowed. One of the allegations of the Ld. CIT DR that assessee has filed additional evidence before the Ld. CIT(A) and therefore, same cannot be entertained, but we are unable to appreciate such a contention raised because apparently there is no additional evidence which has been filed during the course of first appellate proceedings and all the requisite details have been filed before the AO alongwith letters addressed to him, the copies of which have been placed on the paper book. Nothing has been specified in the grounds of appeal by the department as to what is the nature of additional evidence which has been filed before the Ld. CIT(A) and was not there in the records of the AO. Thus, such a contention raised by the revenue in its grounds of appeal is not supported by any material facts and hence same is rejected. Once the details of expenditure have been given and no defect or error has been pointed out by the AO, then same is to be held as allowable expenditure. Accordingly, the order of the Ld. CIT(A) in deleting the said addition is upheld.

13. In the result appeal of the revenue is dismissed.

Order pronounced in the Open Court on 5th October, 2018.

sd/ sd/--

(G.D. AGRAWAL) **(AMIT SHUKLA)**
PRESIDENT **JUDICIAL MEMBER**

Dated: 05/10/2018
Veena

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1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

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