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

SH. R. K. PANDA, ACCOUNTANT MEMBER
AND
MS. SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No. 1341/Del/2010, A.Y. 2005-06

AGR Matthey of Western Australia Through representative assessee PEC Limited Hansalaya, 9th Floor 15, Barakhamba Road, New Delhi-110001 PAN : AAACT0101G **(APPELLANT)**	Vs	ADIT International Taxation Circle 2(1), New Delhi **(RESPONDENT)**

Appellant by	**Sh. S.Krishnan, Sh. V.Raja Kumar, Adv.**
Respondent by	**Sh. G.K.Dhatt, CIT- DR**

Date of Hearing	**11.07.2019**
Date of Pronouncement	**05.08.2019**

ORDER

PER SUCHITRA KAMBLE, JM

This appeal is filed against the order dated 14.12.2009 passed by CIT(A)-XXIX, New Delhi for assessment year 2005-06.

2. The grounds of appeal are as under :-

1) *"That the order of the learned Commissioner of Income Tax (Appeals)-XXIX, New Delhi (hereinafter referred to as CIT(A)) is wrong on facts and bad in law.*

2) *That on the facts and in the circumstances of the case, the learned CIT(A) has erred in confirming the addition of Rs. 25,71,10,851/- by way of disallowance of expenditure incurred for earning the income from*

usance interest.

3) *That on the facts and in the circumstances of the case, the learned CIT(A) has erred in confirming the disallowance of expenditure of Rs. 25,71,10,851/- by not appreciating the provisions of the DTAA between India and Australia.*

4) *That on the facts and in the circumstances of the case, the learned CIT(A) has erred in not appreciating the fact that granting of credit (facility to pay later) to the Indian buyer and in turn discounting of bills on payment of discounting charges relate to the same transaction of sale on credit and has consequently further erred in not allowing the discounting charges incurred by the assessee as deduction from the interest received from the Indian party.*

5) *That without prejudice to the above mentioned grounds, the learned CIT(A) has erred in not allowing the expenditure to earn the interest income even though the Assessing Officer had held the expenditure to be business expenditure and interest income as Income from Other Sources since the business expenditure can be set off against the income from other sources in the same assessment year as per provisions of section 71 of the Income Tax Act, 1961.*

6) *That the Appellant craves leave to reserve to itself the right to add, alter and/or vary any ground(s) at or before the time of hearing."*

3. The assessee is a seller of gold/bullion to PEC, a Government of India undertaking and nominated agency for import of bullion, against issuance of letters of credit. Against supplies of gold by the assessee to PEC, PEC establishes a issuance of letter of credit in favour of the assessee for 90/180/360 days credit. The assessee accepts the LC through its bankers in Australia. As per the terms of LC the assessee is entitled to charge interest at the rate of LIBOR plus a margin of 0.5% per annum. In its return of income filed on 18.05.2006, the assessee declared an amount of Rs. 25,71,10,851/- as interest income. Against this income the assessee claimed expenses of an equal amount on account of discounting of various LCs received from PEC and discounted with its bankers in Australia which

have been disallowed by the Assessing Officer in the assessment proceedings.

4. Being aggrieved by the assessment order the assessee filed appeal before the CIT(A). The CIT(A) dismissed the appeal of the assessee.

5. The Ld. AR submitted that the issue arising in the subject appeal relates to an addition in respect of Usance interest in a sum of Rs.25,71,10,851/-. The CIT (Appeals) at para 5 of the impugned order observed that the assessee is an Australian Company which has sold bullion to PEC Ltd., a government of India Company. Its return of income stands filed by PEC Ltd. in the capacity of representative assessee. Thus, claims made in the return are not claims of the assessee, but made unilaterally by PEC Ltd. The CIT(A) further observed that on 18.10.2001 the Assessee and PEC Ltd. agreed upon a transaction of sale of gold and silver bars by the Assessee to PEC Ltd. From the perusal of the letter of understanding especially from the schedule therein, following steps would be undertaken to consummate the transaction:

Day 0	PEC Ltd. would receive provisional invoice from Assessee for LC opening;
Day 1	Assessee would receive the LC from PEC Ltd. via its bank in Australia for discounting;
Day 3	Bullion would be dispatched by assessee to PEC Ltd. to arrive in India;
Day 4 to 8	Assessee to discount LC with ANZ Bank, Australia and to receive proceeds at that stage itself;
Day 180	Assessee bank in Australia to receive proceeds from PEC Limited's bank in India as per LC.

Thus, even before the transaction took place, parties were ad-idem that there would be no effective credit period vis-a-vis the transaction and that credit period was being calibrated by leveraging the services of the parties' respective banks. The Ld. AR submitted that this is the recognized mode of

trading in bullion globally. Apart from obtaining requisite credit for parties, the method also hedges parties from risk associated with such high value transactions. The Ld. AR further pointed out that on 20.02.2006 also, confirmatory details with regard to this method of operation were made out, and filed before the Assessing Officer. But the authorities below have held the notional interest income as arising from the credit period of 180 days to be income in the hands of the assessee, without noticing that such interest is completely notional and has never been received by the assessee. In fact, PEC Ltd. itself confirmed the same in the computation of income. The Ld. AR submitted that there is in fact no interest credit, since within a day or two of usance of letter of credit by PEC Ltd's bank to the Assessee, letter of credit stands discounted by the Assessee with ANZ Bank of Australia. The cost of discounting letter of credit is identical and equal to the notional interest in respect of the letter of credit itself. The Assessing Officer admits in his order that interest in this case is not interest simplicitor, i.e., it does not arise out of a loan liability. It is, in the context of a transaction of high-seas sale of bullion, a part of the cost of such bullion itself. Both the authorities below having returned concurrent finding of fact that such interest is in the nature of business expenditure and stands incurred purely to facilitate the transaction of sale of bullion, they have erred in not seeking to assess such interest under provisions of business income, and have travelled arbitrarily and erroneously to the residual chapter under the Act i.e. income from other sources. Thus, the Ld. AR further submitted both Usance interest and the discounting charges were part of the sale transaction as duly entered into by parties, it was not open to the revenue authorities to reckon one and ignore the other. The authorities below have only sought to test the transaction under Chapter IV F of the Act rather than in terms of Chapter IV D, to which this transaction belongs. For this purpose, they have relied upon the disclosure as made in the return dated 18.05.2006. The Ld. AR submitted that this premise is patently incorrect for two reasons; firstly, this is a case where a claim in the return has not been made by the Assessee at all, but by PEC Ltd. as representative assessee and secondly, PEC Ltd. has filed a return of income at 'NIL' on the Assessee's

behalf, claiming interest paid by them to their own bank on one side and deducting an identical amount against the same in respect of interest retained by the Assessee's bank for the period of such credit. Thus, this is not even a case where a claim has been made for interest under income from other sources. The Ld. AR submitted that the interest itself is notional and has never been received by the assessee and can be seen from the computation of income wherein it is demonstrated that the Assessee has never received any interest from PEC Ltd. at all - such interest has been paid by PEC Ltd. to its bank. The Ld. AR further submits that live link between interest credit and discounting cost as per the modus operandi agreed upon between the parties and duly followed in the subject case, the process of consummating the transaction itself was based on the accepted and normal device of the seller discounting letter of credit to have that transaction financed by the parties' respective banks. The authorities below, in the face of evidence demonstrating the live nexus between the two, erred grossly in picking one and ignoring the other. The Ld. AR further submitted that interest in the present case is part of the cost of the bullion itself - The Assessing Officer as well as the CIT (Appeals) have both have been pains to point out how the notional interest as well as the discounting charges were not part of any loan liability, but were part of a business transaction. Findings of the Assessing Officer at page 4 and of the CIT (Appeals) at para 7 of the impugned orders are relied upon in this regard. In view of the ratio of the Hon'ble Supreme Court in the case of CIT Vs. Cocanada Radhaswami Bank Ltd. (1965) 57 ITR 306 (SC) as well as in view of the binding precedent of the Hon'ble Delhi High Court on identical facts in the case of CIT Vs. Cargill Global Trading (P.) Ltd. (2011) 11 Taxmann.com 219 (Del.), such interest partakes of the character of the purchase price itself and could not have been put to tax under the residual head of income from other sources. The Revenue Authorities have conveniently omitted to seek to test the transaction under provisions of business income, because they were well aware that in the absence of a permanent establishment of the Assessee in India, no liability to tax could be fastened upon it. The recital in Article 7 of the DTAA between India and Australia is crystal clear in this respect. The

findings of the Hon'ble Delhi High Court at paras 9 to 12 of the judgment in the case of CIT Vs. Cargill Global Trading (P.) Ltd. (supra) cover the subject case to the hilt. The authorities below could not have treated the notional interest as anything except business income, under which such income was not due to be taxed in India at all. The Ld. AR submitted that Article 11(1) has been completely ignored by the Revenue Authorities - Even if the notional interest were sought to have been treated as interest simpliciter, the CIT (Appeals) has erred in omitting to consider Article 11(1) of the Indo-Australian DTAA. As per Articles 11(1) and 11(2) of the said Treaty, interest income is alternatively taxable in the country of residence of the recipient party, in the present case, Australia. In order to invoke Article 11(2), a heavy onus is cast to establish how "according to the law of that State" such interest could be taxed in India. In CIT Vs. Cargill Global Trading (P.) Ltd. (supra), it has already been held that such interest is not interest within the meaning of section 2(28A) of the Act. The invocation of Article 11(2) without compliance of the condition precedent therein, i.e. to point out under which provision such interest was taxable in India has never been done, and the authorities below have conveniently relied upon the Assessee's own claim, without noting that this is a case where the claim stands made not by the Assessee but by a representative assessee. This is a transaction of sale of bullion - Especially in the context of a transaction of bullion sale on high-seas basis, wherein the price of the product varies on day to day basis, any interest cost or credit would only form a part of the cost of goods. In that view of the matter, the authorities below grossly erred in holding the notional usance interest to be interest to be taxed as income from other sources. The Ld. AR submitted that reference to section 57 of the Act is misconceived. The CIT (A) ignored the aspect of discounting cost and held that for allowance under section 57 of the Act, the discounting charges should have been paid only 'for the purpose of earning the interest'. This premise itself is palpably erroneous in view of the CIT (A)'s own finding that the interest credit as well as the discounting cost have arisen from a business transaction on sale of bullion, and not from any transaction referred to in section 56 of the Act. The authorities below have even failed to

point out how section 56 of the Act is applicable in the subject case. In view of the facts and averments as made hereinabove, the Ld. AR submitted that the revenue authorities have completely failed to understand the transaction as entered into by the Assessee with PEC Ltd. and merely sought to pounce on one stray notional credit only with a view to create a tax liability. The same is misconceived on facts and in law and merits to be reversed, with directions for relief to the Assessee.

6. The Ld. DR submitted that the assessee is a non-resident ["Status-Foreign Company" as per assessment order which was not challenged] which does not have a PE in India. The Ld. DR submitted that the claim of the Ld. AR that PEC has filed the ROI in the capacity of representative assessee will not change the status of the assessee from Non-resident to Resident. The Ld. DR submitted that it has sold precious metals to PEC India who issues a LC from an Indian bank in respect of purchases made by it. The assessee also charges interest from PEC which is shown in the computation of income where the assessee itself recognizes the receipt as "Interest". Similarly, in page-14 of the paper book the assessee acknowledges that "AGR is entitled to charge interest" apart from the sales consideration. The assessee offered to tax interest received by it from PEC under Art-11 of the Indo- Australian DTAA. The Assessee claims the charges paid by it to ANZ Bank at Australia as deductible expenses from the interest it received from PEC. The first issue that needs to be examined is the nature of the income of Rs. 25,71,10,851/- included in the “statement of Assessable Income”. The following facts clearly prove that the above income is in the nature of “Interest” and not part of “Profits and gains of Business and profession”. The assessee itself has claimed and accepted that Rs. 25,71,10,851 received from PEC is in the nature of "Interest" income, the Assessing Officer & the CIT(A) are right and justified in treating the same as a separate and independent source of income distinct from the business of the assessee. The Ld. DR submitted that the assessee is claiming benefit of deduction of expenditure as per Art-11(2) of the DTAA between India and Australia, the interest may be taxed in the contracting state (India) in which

it arises and according to the law of that state. ” The Ld. DR submitted that it may not be out of context that the assessee has selectively quoted the provisions of Art- 11(2) and omitted the rest of the provisions of the said article i.e. *"but the tax so charged shall not exceed 15 per cent of the gross amount of the interest'*. During the course of hearing, the Ld. AR claimed that Revenue need to establish the applicability of Art-11(1) before going to Art-11(2) but here the assessee itself claims benefits under Art-11(2) thereby accepting the applicability of Art-11(1) itself. Moreover, the assessee has accepted the taxing rights of the source country i.e. India and its liability to file its return of income and offer the income accruing and arising from India - in the absence of a PE - only because of the operation of Art-11(l) of the DTAA. The Ld. DR further pointed out another important fact that the assessee has nowhere established and proved that the said income has been offered to tax in Australia or for that matter the expenses claimed against such income have not been claimed against its income accruing & arising at the country of residence i.e. Australia. Art-11 (1) grants the source state [i.e. India] the right of taxation of Interest. Art-11(2) provides file mechanism of taxation of such interest and the procedure for relieving double taxation. Accordingly, the interest of a non resident has to be taxed on "gross amount" [i.e. without allowance of any expenditure] and at a lower rate [i.e. 15%] than the rate applicable to the domestic taxpayers. *However, if the non-resident has a PE, the provisions of Art-7 shall be applicable and the interest will be taxed higher rate on a net basis.* The Ld. DR pointed out that the assessee is claiming for the deduction of expenses incurred outside India. No doubt the DTAA between India & Australia provides for the allowability of expenses "whether incurred in the Contracting State in which the permanent establishment is situated (India) *or elsewhere* (outside India)". However, such a benefit is allowable only in the presence and involvement of the PE. In other words, in the absence of a PE, neither the assessee is eligible to be taxed on a net basis nor the expenses incurred by it outside the source country [i.e. in the country of residence Australia] are allowable as expenses. Accordingly, since the assessee has elected to be governed by DTAA, in the absence of a PE, the AO is correct in taxing the

interest income on a gross basis as per the provisions of Art-11(2) of the DTAA. Both the AO & CIT (A) have held that charging interest from PEC is a separate transaction which has resulted in the earning of interest income - thereby accepting the claim of the assessee. Hence expenditure incurred for earning this income thus, has to be examined from the perspective as to whether the assessee is governed by the domestic law or DTAA and if the assessee is held to be governed by the domestic law as well as whether such expenses are allowable as per the provisions of Sec. 57 (iii) of the Act. Since the assessee does not have a PE in India, the applicability of the domestic law in the form of provisions of Section 57 (iii) does not arise. Without prejudice to the above and assuming without accepting that the provisions of domestic law is applicable to the assessee in the absence of a PE, no deduction u/s 57(iii) is allowable to the assessee because the expenses in question have been incurred in Australia and not in India. The Ld. DR further submitted that there is no evidence that the said amount has not been claimed as deduction against the income offered to tax in Australia and here is not an iota of evidence to prove that this is an expenditure laid out or expended wholly and exclusively for the purpose of earning interest income in India. Thus, the Ld. DR submitted that the assessee cannot opt for a net basis of taxation after deduction of expenses under domestic law and at a lower rate of taxation under DTAA at the same time. This will defeat the very purpose of DTAA by enabling and encouraging "double non-taxation" [both juridical as well as economic] where such amount will neither be taxed in Australia nor in India resulting thereby in 'Fiscal Evasion' which is against the intentions of the DTAA as stated in its preamble.

7. We have heard both the parties and perused all the relevant material available on record. From the records it can be seen that there is no interest credit, since within a day or two of usance of letter of credit by PEC Ltd's bank to the Assessee, letter of credit stands discounted by the Assessee with ANZ Bank of Australia. The cost of discounting letter of credit is identical and equal to the notional interest in respect of the letter of credit

itself. The Assessing Officer also admits in the assessment order that interest in this case is not interest simplicitor, i.e., it does not arise out of a loan liability. The interest is in the context of a transaction of high-seas sale of bullion, a part of the cost of such bullion itself. Thus, the same is in the nature of business expenditure and incurred only to facilitate the transaction of sale of bullion. Both Usance interest and the discounting charges were part of the sale transaction as duly entered into by parties, but revenue authorities erred in giving finding which is contrary to their own narration of the facts. This claim is made by PEC Ltd. as representative of assessee and PEC Ltd. has filed a return of income at 'NIL' on the Assessee's behalf, claiming interest paid by them to their own bank on one side and deducting an identical amount against the same in respect of interest retained by the Assessee's bank for the period of such credit. Thus, this is not a case where a claim has been made for interest under income from other sources. The interest itself is notional and was never received by the assessee. This is properly demonstrated by the assessee from the computation of income. The live link between interest credit and discounting cost as per the modus operandi agreed upon between the parties and duly followed in the subject case, the process of consummating the transaction itself was based on the accepted and normal device of the seller discounting letter of credit to have that transaction financed by the parties' respective banks. The authorities below, in the face of evidence demonstrating the live nexus between the two, erred grossly in picking one and ignoring the other. The interest in the present case is part of the cost of the bullion itself. The Assessing Officer as well as the CIT (Appeals) both failed to looked into this aspect. In view of the ratio of the Hon'ble Supreme Court in the case of CIT Vs. Cocanada Radhaswami Bank Ltd. (1965) 57 ITR 306 (SC) as well as in view of the binding precedent of the Hon'ble Delhi High Court on identical facts in the case of CIT Vs. Cargill Global Trading (P.) Ltd. (2011) 11 Taxmann.com 219 (Del.), such interest partakes of the character of the purchase price itself and could not have been put to tax under the residual head of income from other sources. The Revenue Authorities have conveniently omitted to seek to test the transaction under provisions of

business income, because they were well aware that in the absence of a permanent establishment of the Assessee in India, no liability to tax could be fastened upon it. Article 7 of the DTAA between India and Australia is clear in this respect. The findings of the Hon'ble Delhi High Court in the case of CIT Vs. Cargill Global Trading (P.) Ltd. (supra) is applicable in the present case. The revenue authorities should not have treated the notional interest as anything except business income, under which such income was not due to be taxed in India at all. Article 11(1) was not at all considered by the Revenue Authorities - Even if the notional interest were sought to have been treated as interest simpliciter, the CIT (Appeals) has erred in omitting to consider Article 11(1) of the Indo- Australian DTAA. As per Articles 11(1) and 11(2) of the said Treaty, interest income is alternatively taxable in the country of residence of the recipient party, in the present case, Australia. In order to invoke Article 11(2), a heavy onus is cast to establish how "according to the law of that State" such interest could be taxed in India. In CIT Vs. Cargill Global Trading (P.) Ltd. (supra), it has already been held that such interest is not interest within the meaning of section 2(28A) of the Act. The invocation of Article 11(2) without compliance of the condition precedent therein, i.e. to point out under which provision such interest was taxable in India has never been done, and the authorities below have conveniently relied upon the Assessee's own claim, without noting that this is a case where the claim stands made not by the Assessee but by a representative assessee. This is a transaction of sale of bullion - Especially in the context of a transaction of bullion sale on high-seas basis, wherein the price of the product varies on day to day basis, any interest cost or credit would only form a part of the cost of goods. In that view of the matter, the authorities below grossly erred in holding the notional usance interest to be interest to be taxed as income from other sources. Reference to section 57 of the Act is misconceived. The CIT (A) ignored the aspect of discounting cost and held that for allowance under section 57 of the Act, the discounting charges should have been paid only 'for the purpose of earning the interest'. This premise itself is palpably erroneous in view of the CIT (A)'s own finding that the interest credit as well as the discounting cost have arisen from a

business transaction on sale of bullion, and not from any transaction referred to in section 56 of the Act. The authorities below have even failed to point out how section 56 of the Act is applicable in the subject case. The revenue authorities have completely failed to understand the transaction as entered into by the Assessee with PEC Ltd. and merely sought to pounce on one stray notional credit only with a view to create a tax liability. All these submissions made by the Ld. AR was not considered by the Assessing Officer as well as by the CIT(A) which not correct on the part of the Revenue authorities. Therefore, we set aside the order of the CIT(A) and appeal of the assessee is allowed.

8. In result, the appeal of the assessee is allowed.

Order pronounced in the Open Court on 05th August, 2019.

Sd/-	**Sd/-**
(R.K.PANDA)	**(SUCHITRA KAMBLE)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Dated: 05/08/2019
Binita

Copy forwarded to:

1.	Appellant
2.	Respondent
3.	CIT
4.	CIT(Appeals)
5.	DR: ITAT

ASSISTANT REGISTRAR

ITAT NEW DELHI