IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "I", MUMBAI

BEFORE JUSTICE (RETD.) C. V. BHADANG, PRESIDENT

SHRI SAKTIJIT DEY, VICE PRESIDENT

AND

MS. PADMAVATHY S, ACCOUNTANT MEMBER

ITA No. 1342/Mum/2006
Assessment Year: 2002-03

Mashreq Bank Psc, 1305, Raheja Centre, 13th Floor, Nariman Point, Mumbai	**Vs.**	DCIT (IT)-3(2), Mumbai
PAN : AAACM 4303 M		
(Appellant)		**(Respondent)**

Assessee by	Shri Percy Pardiwala, Sr. Adv & Shri Madhur Agarwal, Adv.
Department by	Shri Vivek perampurna (CIT-DR)

Date of hearing	21.01.2025
Date of pronouncement	06.02.2025

ORDER

PER SAKTIJIT DEY, VP:

Captioned appeal of the assessee arises out of order dated 12.12.2005 of learned Commissioner of Income Tax (Appeals)-XXI, Mumbai, pertaining to assessment year 2002-03.

2. Before we proceed to deal with specific issues arising in the appeal for our consideration, it is necessary to provide a brief factual background leading to the constitution of Special Bench, before which the instant appeal was placed for hearing. This appeal came up for hearing earlier before a Division Bench of the Tribunal on 7th January, 2016. The appeal was disposed of vide order dated 15th January, 2016 by partly allowing the appeal. However, the major issue relating to allowance of head office expenses was decided against the assessee. Subsequently, assessee filed a miscellaneous application seeking recall of the order on the ground that while deciding the issue the Tribunal had not taken note of its decision in assessee's case in assessment years 1998-99 and 2001-02, though, cited by the assessee. Allowing the miscellaneous application filed by the assessee, the Tribunal recalled the earlier appellate order for the limited purpose of deciding ground nos. 1 and 4. After the appeal order was recalled, as aforesaid, the Revenue requested for constitution of a Special Bench for resolving the issues. Keeping in view the conflicting decisions of the Tribunal in assessee's own case, the Hon'ble President accepted the request of Revenue and constituted a Special Bench for deciding ground nos. 1 and 4

arising in the present appeal. This is how the appeal came up for hearing before this Bench.

3. Ground nos. 1 and 4 are as under:

1. *The Commissioner of Income-tax(Appeals)-XXI, Mumbai (hereinafter referred to as the CIT(A)) erred in upholding the action of the Deputy Director of Income-tax (IT)-3(2), Mumbai (hereinafter referred to as the AO) in disallowing the appellants claim for deduction of head office expenses of Rs. 1,78,07,340 allocated to the Indian branches.*

   The appellants submit that the entire amount of Rs. 1,78,07,340 should be allowed as a deduction as per the provisions of Article 7(3) of the convention between the Government of U.A.E. and the Government of India (hereinafter referred to as the Tax Treaty).

   The appellants further submit that in computing the taxable business income in India, the tax treaty allows a deduction for all expenses wherever incurred and reasonably allocable to the permanent establishment, including its share of executive and general administrative expenses. As the treaty overrides the domestic law, the amount allocated by the Head Office should be allowed as a deduction in full.

   The appellants pray that the AO be directed to allow the entire amount of head office expenses.

4. *The CIT(A) erred in confirming the action of the AO in not allowing a deduction of Rs.3,58,421 under Section 37 of the Act being expenses specifically incurred outside India for the Indian Branches and thereby processing the same under Section 44C of the Act.*

   (i) The expenditure of Rs.3,58,421 has been incurred on account of following:

   Swift expenses (charged to Indian operations on actual usage basis) 1,68,349

   Globus Accounting Software maintenance Expenses (charged to Indian operations on number of usage basis) 1,90,072

   (ii) These expenses are directly connected and necessary for the smooth functioning of the operation of the Indian branches.

(iii) These expenses are not in the nature of general administrative expenditure and are not required to be processed under the provisions of Section 44C of the Act.

The appellants pray that the AO be directed to allow the expenditure of Rs.3,58,421 under Section 37 of the Act.

4. In ground no. 1, the assessee has challenged disallowance of deduction claimed of head office expenses of Rs.1,78,07,340/- allocated to the Indian branches. Whereas, in ground no. 4, assessee has challenged disallowance of deduction claimed of Rs.3,58,421/-, being expenses specifically incurred outside India for the Indian branches.

5. The material facts relevant for deciding these issues are, the assessee is a non-resident banking company incorporated in United Arab Emirates (UAE) and operates in India through its branches in Mumbai and New Delhi. As stated by the Assessing Officer, in the assessment year under consideration, assessee had carried out corporate banking business and had undertaken foreign exchange business only to the extent of covering operations for its existing clients.

6. For the assessment year under dispute, the assessee had initially filed a return of income on 31.10.2002 declaring book profit under section 115JB of Rs.3,19,76,508/-. Whereas, It offered nil business income after set off of brought forward losses.

Subsequently, assessee filed a revised return of income on 01.12.2003 declaring total loss of Rs.17,78,01,164/-. In course of assessment proceeding, the Assessing Officer, while verifying note no. 4, annexed to the return of income, noticed that the assessee had stated that it has not claimed any deduction on account of head office expenses, since, it has returned loss, but, reserves its right to claim deduction at 5% as per section 44C of the Act. Without prejudice, the assessee submitted that as per Article 7(3) of India-UAE Double Taxation Avoidance Agreement (DTAA), all expenses incurred for the purpose of business of the Permanent Establishment (PE), including, the executive and administrative expenses, are allowable without applying the restriction imposed under section 44C of the Act. The Assessing Officer, however, did not find merit in the submissions of the assessee. Relying upon decision taken in the past assessment years, the Assessing Officer held that head office expenses are allowable in terms with section 44C of the Act and accordingly, he held that assessee is entitled to get deduction at the rate of 5% of the average adjusted total income. Further, he observed, certain expenditure incurred outside India, such as, swift expenses amounting to Rs.1,68,349.17 and Globus Accounting Software Maintenance

Expenses of Rs.1,90,072.08, both, aggregating to Rs.3,58,421/- have been debited to the profit and loss account. When called upon to justify the claim, the assessee submitted that these expenses were directly connected to and incurred for the PE in India, hence, would not be covered under the expression "General and Administrative Expenses" coming within the ambit of section 44C of the Act. This claim of assessee was also rejected by the Assessing Officer. Assessee contested both the disallowances before learned first appellate authority. However, disallowances were confirmed.

7. In course of hearing, Shri Percy Prdiwala, learned Senioor counsel for the assessee advanced detailed submissions, both orally and in writing. Broad propositions put forward by him, insofar as, general and administrative expenses allocated to Indian Branches, can be summarized as under:

- Head office expenses are fully deductible as per Article 7(3) of India-UAE DTAA, as, there is no condition or restriction imposed therein that the deduction would be allowable subject to the provisions of taxation laws of India.

- Wherever, India wanted to provide for limitations of the domestic law to apply while applying the treaty, the same has been specifically provided in the treaty.
- Article 7(3) of the DTAA was amended with effect from 1st April, 2008, wherein, the restriction of applicability of the domestic law while computing the income under the treaty was inserted. However, the protocol amending the provisions of treaty would be applicable from the date when it comes into effect, hence, cannot have retrospective applicability.
- Wherever, the amendment is to be applied retrospectively, it has to be mentioned in the protocol and the notification issued by the Central Government for application of the protocol.
- Article 25(1) of the DTAA between India and UAE does not imply that the deduction of head office expenses is allowable as per domestic tax law, even, before the amendment of Article 7(3) of the DTAA for years prior to 1st April, 2008. It is submitted, if the limitation existing in terms of section 44C was applicable in view of Article 25(1) of the Treaty even for period prior to 01.04.2008, the amendment to Article 7(3) of the Treaty was not required.

- The decision of the Tribunal in assessee's own case in assessment year 1996-97 is no longer good law in view of the Protocol dated 3rd October, 2007 of India-UAE DTAA and the decision of the Special Bench in case of Sumitomo Mitsui Banking Corporation [2012]19 taxmann.com 364 (SB).
- The Treaty between two sovereign countries has to be interpreted in good faith in accordance with ordinary meaning to be given to the terms of the Treaty in their context and in the light of its objects and purpose. Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of the provision has to be taken into account while applying the provisions of the treaty. In this context, learned counsel for the assessee referred to Article 31 of Vienna Convention on Law of Treaties. In support of his contention, learned counsel relied upon the following decision:

    a) *Decision of the Mumbai Tribunal in assesse's own case for A.Y: 1998-99 and 2001-02, in ITA No. 4050/Mum/2004.*
    b) *Decision of Mumbai Tribunal in the case of Abu Dhabi Commercial Bank Limited for AY: 1995-96 to 2000-01 [2012] 23 Taxmann.com 359*

c) *Decision of Mumbai Tribunal in case of State Bank of Mauritius (2013) 25 taxmann.com 555*

d) *Decision of Mumbai Tribunal in case of DDIT (IT)-2(1) Vs. Toyo Engineering Corp. (2012) 136 ITD 268*

e) *Decision of Kolkata Special Bench in case of ABM Amro Bank N.V. Vs. ADIT (IT)-1 & ADIT (IT)-1 Vs. Bank of Tokyo Mitsubishi Ltd. (2005) 97 ITD 89*

f) *Azadi Bachao Andolan (132 Taxman 373) (SC)*

g) *Decision of Jaipur Bench ITAT in the case of ITO vs. Degremont International (1985) (11 ITD 564)*

h) *Decision of Mumbai, ITAT in case of Credit Llyonnais Vs. DCIT (2004) (ITA Nos. 6539 & 6701/Bom/95*

i) *Decision of Delhi ITAT in the case of DDIT Vs. Unocol Bharat Ltd. (ITA No.1388/Del/2012), dated 5th October, 2018*

8. Drawing our attention to Article 25(1) of the Tax Treaty, learned Departmental Representative submitted, the term 'taxation of income' used in Article 25(1) will also include computation of such income to be taxed, as, computation is an integral part of taxation. He submitted, a reading of Article 25(1) of the treaty would make it clear that the laws of the Contracting States would continue to govern the taxation of income unless there is an express provision in the Treaty restricting application of domestic tax laws. He submitted, since, the income under the Act has to be computed as per the provisions of section 28 to 44,

including section 44C, in absence of any express provision restricting the application of domestic law provisions, as per Article 25(1) of the Treaty, income has to be computed by applying the provisions of the Act. Hence, the head office expenses allocated to the Indian branches have to be allowed in terms with section 44C of the Act. He submitted, use of words 'express provision to the contrary' in Article 25(1) would mean, there should be a provision expressly denying the applicability of section 44C. Drawing our attention to Article 7(3) of the Treaty, he submitted, there is no such express provision contained therein denying applicability of section 44C of the Act. He submitted, even prior to the Protocol amending Article 7(3) w.e.f. 01.04.2008, a harmonious construction of Article 25(1) and Article 7(3) would leave no room for doubt that section 44C would be applicable, even, while allowing deduction of head office expenses under Article 7(3) of the Treaty. He submitted, the Protocol amending Article 7(3) only clarifies the position existing earlier, as, even without considering the amendment, the deduction as per Aritcle 7(3) [(whether without considering Aritcle 25(1) or after considering Article 25(1)] was always subject to section 44C of the Act. Referring to UN Commentary on Model

Tax Convention of 2011, he submitted, even without considering the provisions of Article 25(1), Article 7(3) is not intended to be interpreted in a manner so as to disregard any specific legislative provision placing a monetary or other ceiling on the deduction of business expenditure. Referring to OECD-MTC, 2008 commentary of Model Tax Convention, vis-à-vis, Article 7(3), learned Departmental Representative submitted that Article 7(3) only determines which expenses should be attributed to the PE for the purpose of determining the profit attributable to the PE and it does not deal with the issue whether those expenses, once attributed, are deductible while computing the taxable income of PE, since, the conditions for the taxability of expenses are a matter to be determined by domestic law, subject to, the provision of Article 24 on non-discrimination. He submitted, in case of Engineering Analysis Centre of Excellence Pvt. Ltd., 432 ITR 471, the Hon'ble Supreme Court has observed that OECD Commentary has persuasive value in interpretation of Tax Treaties.

9. Thus, he submitted, even considering Article 7(3) of the Tax Treaty on standalone basis, it has to be interpreted that expenses attributable to the PE has to be allowed as deduction, subject to,

the limit permitted under the Act. He submitted, since section 44C is a specific provision limiting the head office expenditure, it cannot be said that deduction of such expenditure under Article 7(3) is not subject to the restriction imposed under section 44C of the Act. He submitted, if such interpretation is given to Article 7(3), it will lead to absurdity, inasmuch as, other limitations of sections 28 to 44 would also not apply and expenditure may be allowed irrespective of the fact, whether it is capital or revenue in nature, and whether tax is deductible at source or not etc. In support of such contention, he heavily relied upon the decision of the Tribunal in assessee's own case in assessment year 1996-97. To buttress his argument with regard to the terminology of "express provision" used in Article 25(1), learned Departmental Representative relied upon the decision of Maru Ram & Ors. Vs. Union of India, AIR 1980 SC 2147. He submitted, various decisions relied upon by learned counsel for the assessee have not laid down correct proposition of law with regard to the applicability of Article 7(3). He submitted, in none of these decisions, interpretation of Article 7(3), as provided in UN and OECD Commentaries, as also, the meaning of the word 'express provision to the Contrary' as interpreted by Hon'ble Supreme

Court in case of Maru Ram & Ors Vs. Union of India (supra) has been considered while interpreting Article 25(1). Further, he submitted, the decision in case of Abu Dhabi Commercial Bank (supra) has erroneously relied upon the case of Sumitomo Mitsui Banking Corporation (136 ITD 66), since the Special Bench was never called upon to decide the issue relating to deduction of head office expenses and the decision was rendered in the context of deduction of interest expenditure, being interest paid to head office and its taxability at the hands of head office. Thus, he submitted, the departmental authorities were correct in computing the deduction of head office expenditure in terms with section 44C of the Act.

10. In rejoinder, learned Senior Counsel for the assessee submitted, reliance on the decision of Maru Ram & Ors Vs. Union of India (supra) is totally misplaced as Hon'ble Supreme Court has held that section 433A of Criminal Procedure Code, being a specific provision states that in case of a person imposed with life imprisonment or death sentence commuted under section 433 to life imprisonment, then such person shall not be released from prison unless he has served at least fourteen years of imprisonment. He submitted, Hon'ble Supreme Court has held

that section 433A being a specific provision will prevail over section 5 of Procedure Code as it expressly states that specific provisions, if any, to the contrary will prevail over any special or local law. On the contrary, he submitted, in case of Sumitomo Mitsui Banking Corporation, the Special Bench of Tribunal has held that if there is an express provision made in the convention giving benefit to the assessee, which is contrary to the domestic law, then the provision of the treaty can be relied upon, as, it will override and prevail over the provisions of the domestic law to give any benefit expressly given to the assessee under the treaty. He submitted, in case of State Bank of Mauritius (ITA Nos. 2254 & 3005/Mum/2005 dated 26.09.2012) relied upon by learned Departmental Representative, the Tribunal has disallowed capital expenditure incurred for acquisition of fixed assets on the proposition that the profits mentioned in the DTAA are commercial profits while the capital expenditure incurred is not allowable while determining commercial profit. He submitted, assessee's case stands on a different footing as head office expense is revenue expenditure. Further, he submitted, in the very same decision of State Bank of Mauritius (supra), the Bench has allowed entire expenses under Article 7(3) of the Tax Treaty

and has held that provisions of section 43B of the Act is not applicable. He submitted, even the reliance on the case of Mitsubishi Heavy Industries Ltd.(61 TTJ 656) is misplaced as the issue of applicability of section 44C in computing the income under DTAA was decided in favour of the assessee.

11. We have carefully considered the rival submissions and perused the materials on record. We have applied our mind to the judicial precedents cited before us, as well. The issue arising for consideration is, whether head office expenses allocated to the PE in India is allowable under Article 7(3) of the treaty without any limit or subject to the restrictions imposed under section 44C of the Act. After carefully examining the various decisions placed before us, we find, there are two viewpoints on the issue. As per the first viewpoint, Article 25(1) of India – UAE Tax Treaty provides for applicability of domestic law for computation of income, unless, there is an express provision in the agreement restricting such applicability. Upon interpreting Article 7(3) of the Treaty it has been held that, since, it does not contain any restrictive covenant regarding applicability of domestic law provisions, the restrictions imposed under domestic law cannot be imported. The Benches have held that Article 7(3), being an

express provision provided in the DTAA, as referred to in Article 25(1) of the treaty, it will override the provisions of domestic law, including section 44C. While doing so, the subsequent amendment made to Article 7(3) by Protocol dated 28.11.2007 was also taken note of and it was held that only after the amendment to Article 7(3) w.e.f. 01.04.2008, the deduction allowable would be subject to the domestic law provisions. The aforesaid proposition has been laid down in the following decisions:

1. *DDIT(IT)-2(1) vs. Toyo Engineering Corp. [2012] 136 ITD 268*
2. *ITO vs. Degremont International [1985] 11 ITD 564*
3. *Credit Llyonnais vs. DCIT [2004] ITA nos.6539 & 6701/Bom/95)*
4. *DDIT vs. Unocol Bharat Ltd. (ITA No. 1388/Del/2012) vide order dated 05.10.2018*
5. *Decision of Mumbai Tribunal in the case of Abu Dhabi Commercial Bank Limited for AY: 1995-96 to 2000-01 [2012] 23 Taxmann.com 359*
6. *Decision of Mumbai Tribunal in case of State Bank of Mauritius (2013) 25 taxmann.com 555*

12. Whereas, there is a second viewpoint on the issue, which says that Article 25(1) clearly provides for computation of income as per respective laws of the Contracting States in absence of any express provision. It has been held that Article 7(3) cannot be interpreted in a manner to say that it excludes applicability of

domestic law provisions including section 44C. The aforesaid legal proposition has been laid down in assessee's own case in the appeal decided by the Tribunal in assessment year 1996-97. Of course, it will be pertinent to mention here that while deciding assessee's appeals for assessment years 1998-99 and 2001-02, the Tribunal has not followed its earlier decision but has proceeded to accept the first viewpoint and held that Article 7(3) has to be applied without applying the restrictions of section 44C of the Act.

13. Keeping in perspective the conflicting views expressed by different benches of the Tribunal in case of other assessee's as well as in assessee's own case, it is necessary to examine the issue on first principle. Undisputedly, it is a common point between the assessee and the Revenue that assessee would be governed by the provisions of India – UAE DTAA. It is the say of the assessee that head office expenses allocated to the PE has to be allowed in full in absence of any restriction/condition put in Article 7(3) of the Treaty. Whereas, it is the case of the Revenue that Article 25(1) of the Tax Treaty provides for computation of taxable income as per the applicable law of the Contracting States, unless, there is an express provision to the contrary. It is

the case of the Revenue that there is no such express provision in India – UAE DTAA to exclude applicability of section 44C of the Act. In this context, learned Departmental Representative has submitted that there is no such express provision in Article 7(3) of the Treaty restricting applicability of section 44C of the Act. In this context, it is necessary to examine Article 25(1) and Article 7(3) of the Treaty for better understanding.

14. A reading of Paragraph 1 of Article 25 makes it clear that it is in two parts. First part of Article 25(1) says that taxation of income and capital arising in respective Contracting States shall be governed by the domestic laws in force in the respective Contracting Staes. Whereas, the second part of Article 25(1) carves out an exception by providing that where express provisions to the contrary are made in the Treaty, taxation of income and capital in respective Contracting States would be governed by such express provisions and not by the provisions of domestic laws in force in the respective Contracting States. In other words, if there is an express provision in the Treaty conferring benefit to the assessee, which is contrary to the domestic law, then the provision of the Treaty will override the domestic law and would be applicable. This line of interpretation

is also in consonance with section 90(2) of the Act. In our view, Article 25(1) has to be read as a whole and not on piecemeal basis to get the true meaning. It is relevant to observe, there is no change in Article 25(1) of the Treaty prior to or post amendment of Article 7(3). In case of Sumitomo Mitsui Banking Corporation (supra), the Special Bench of the Tribunal, while interpreting Article 23 of India-Japan treaty, akin to Article 25(1) of India-UAE Treaty, observed that only interpretation, which can be assigned to the said Article so as to bring the provision in consonance with section 90(2) of the Act is that if there is an express provision in the treaty giving benefit to the assessee, which is contrary to the domestic law, the treaty provision shall override the provision of domestic law, to the extent, it is more beneficial to the assessee.

15. Whereas, Article 7 of the Treaty provides the mode and manner of taxability of business profit. Paragraph 3 of Article 7 of the Treaty says that while determining the profit of a PE all expenses incurred for the purpose of business of the PE, including executive and general administrative expenses, whether incurred in the State in which the PE is situated or elsewhere, has to be allowed as deduction. A reading of Article 7(3) of the Treaty, as it stood prior to its amendment by the protocol, makes

it clear that there was no restriction imposed regarding the limit of expenditure to be allowed with reference to the PE. nor there was any reference to applicability of domestic law. The language used in Article 7(3) makes it further clear that the deduction of expenditure allowable in respect of the PE is neither subject to any limitation nor restriction imposed under the domestic law as it does not refer to any domestic law provision, including, section 44C of the Act. Thus, in absence of any restriction imposed regarding the limit of expenditure to be allowed, the restriction imposed under the domestic law cannot be read into Article 7(3).

16. There is another aspect to the issue. The contextual interpretation of Article 25 of the Treaty. Article 25 of the Treaty starts with the heading 'Elimination of Double Taxation'. Thus, from the heading of the Article, it becomes clear that it provides the mechanism for elimination of double taxation of income in the Contracting States. Further, on a careful reading of Article 25 as a whole and paragraph 1 of Article 25 in particular, it becomes very much clear that it provides for taxation of income from various sources arising in the respective Contracting States in accordance with laws in force governing the taxation of such income or capital in the particular Contracting State, unless,

there is an express provision to the contrary made in the Treaty. Thus, what the Article provides is, elimination of double taxation in respect of taxation of various sources of income. In other words, what income is to be taxed or made exempt is to be governed by the domestic law, unless, there is an express provision contrary to the domestic law provided in the agreement. However, how a particular type of income is to be taxed and where to be taxed is provided under specific provisions of the Treaty. Therefore, the Treaties have separate provisions ingrained in them for taxability of various items of income, such as, business profits, interest, dividend, royalty, fee for technical services, salary, capital gain, independent personal services etc. Even, many treaties have omnibus provision, akin to Article 22 of India-UAE Treaty, providing for taxation of any income which is not covered under any other Articles of the convention.

17. For the purpose of understanding the role of Articled 25(1) with regard to the manner of computing tax on income arising in each of the contracting state, it is important to look at the principles of "Elimination of Double Taxation" as per OECD (2019), Model Tax Convention on Income and on Capital 2017. As per the said Convention there are two leading principles i.e. the

principle of exemption and the principle of credit and either of these principles, as agreed between the two contracting states, would be followed for elimination of double taxation. Under the principle of exemption, the State of residence does not tax the income which according to the Convention may be taxed in State of Source or State where PE is located. Under the principle of credit, the State of residence calculates its tax on the basis of the taxpayer's total income including the income from the other State of Source or State where PE is located which, according to the Convention, may be taxed in that other State. State of residence then allows a deduction from its own tax for the tax paid in the other State. In other words, under the exemption method, State of residence limits its taxation to that part of the total income which, in accordance with the various Articles of the Convention it has a right to tax and under the credit method, State of residence retains its right to tax the total income of the taxpayer, but against the tax so imposed, it allows a deduction. From the perusal of these principles it is clear that the purpose of Article 25 (Article 23A and 23B of Model Convention), as its title suspects, is restricted only to the principles on how to give credit to the tax on the income arising in either of the contracting state

which are subject to double taxation. The restriction, if any, is only with respect to the extent to which the tax credit can be given as has been provided in Article 25(2) and 25(3) of India UAE-DTAA.

18. It is also relevant to mention here that DTAAs entered into by the countries are generally on broad contours of the Model Tax Convention on Income and Capital. Articles 6 to 21 are to determine, with regard to different classes of income, the respective rights to tax of the State of source or situs and of the State of residence, and Article 22 does the same with regard to capital. The purpose of Articles 23 A and 23 B (Article 25 in our case) is to provide that the State of residence must allow relief so as to avoid double taxation. Articles 24 to 30 are for special provisions in the Convention such as the elimination of tax discrimination in various circumstances, the exchange of information between the tax authorities of the Contracting States etc. Thus the Model Convention has clearly defined the purpose of each of the Articles and there is no overlapping or there is no reason for a conjoint reading of the provisions of the various Articles.

19. Therefore, in our view, the purpose of Article 25(1) can not be expanded to mean the manner of taxing the income in each of the contracting states but is to reiterate that taxing the income arising in each of the contracting states should be either under the domestic law or as per the express provisions contained in the convention. This, when read with Section 90(2) of the Act, would mean that the assessee has option to choose whichever is beneficial to it. Accordingly, Article 25(1) cannot be interpreted to impose restrictions on the manner of computing the tax which is beyond its scope of eliminating double taxation.

20. Article 7 of India-UAE treaty deals with taxability of business profits. Paragraph 3 of Article 7 provides the mode of computation of profit of PE. In that context, it says that while determining the profits of the PE, all expenses incurred for the business of the PE, including executive and general administrative expenses, whether incurred in the State where PE is located or elsewhere, has to be allowed as deduction. Therefore, Article 25(1) cannot be interpreted in a manner to say that it will influence the computation of business profits under Article 7(3) or thrust the restriction imposed under the domestic law for computing the business profits. Article 25(1) and Article 7(3)

operate in different situations. While Article 25(1) deals with elimination of double taxation, Article 7 deals with taxability of business profits and paragraph 3 of Article 7 lays down the mechanism of computation of business profit of PE. Therefore, while computing the business profit PE under Article 7(3) of the Treaty, the language used/employed therein has to be seen.

21. On a careful reading of Article 7(3) of the Treaty, as it existed prior to its amendment, it becomes very much clear that while determining the profit of a PE, all deductions and expenses attributable to the PE have to be allowed. There are no restrictions/conditions imposed in Article 7(3) of the Treaty to limit the expenditure to a particular percentage. Therefore, in absence of any restrictions/conditions expressly provided in Article 7(3), no such restrictions/conditions can either be imported or read between the lines.

22. On a query from the Bench learned Counsel for the Revenue expressed his inability to place on record the object behind bringing the protocol amending Article 7(3) of the Treaty. However, it could possibly be for the reason that the Treaty Partners decided to put a cap on the expenditure allowable while computing business profits of PE to bring Article 7(3) of the treaty

in sync with domestic law provisions and similar provision available in some other treaties entered by India with other countries. Of course, we may hasten to add, the theory of 'reverse discrimination' does not apply to the facts of the present appeal, as, we are concerned with applicability of section 44C of the Act, which arises in case of non-residents alone.

23. Be that as it may, Treaty partners entered into negotiations and the Protocol amending certain provisions in the treaty was signed between the countries, which was made effective from 1st day of April, 2008 by virtue of notification no. SO 2001(E) (NO) 282/2007, dated 28.11.2007. In the said Protocol, the earlier Article 7(3) was substituted by following:

> *"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, in accordance with the provisions of and subject to the limitations of the tax laws of that State."*

24. Thus, in the amended Article 7(3) of the Treaty, specific restriction/condition was imposed providing that the deduction of expenses relating to the PE has to be allowed in accordance with the provisions of and subject to limitations of the tax laws of the particular State where the PE is situated. A reading of the

amended Article 7(3) would make it clear that there were no restrictions/conditions imposed with regard to the limit of deduction of expenses earlier to the Protocol. If Revenue's contention that even without the Protocol amending Article 7(3), Article 25(1) provided for computation of deduction under Article 7(3) as per the provisions of domestic law is accepted, then there was no need for amending Article 7(3) by the Protocol. The amendment of Article 7(3) clearly establishes that the countries to the agreement, prior to the date of Protocol, had intended to allow deduction of all expenses relating to the PE without applying any restrictions/conditions imposed in the domestic laws of the respective Contracting States.

25. One more argument advanced by the Revenue is, restrictions/limitations for deduction of expenses under Article 7(3) was always there in view of Article 25(1) and the Protocol amending Article 7(3) is only for clarifying the position existing earlier. In our view, this argument of Revenue is a nonstarter. Now, it is fairly well established that interpretation of Treaty cannot be made in the same way as interpretation of statute. In this context, the following observations of the Hon'ble Supreme Court in the landmark decision of Union of India Vs. Azadi

Bachao Andolan (2003) 132 Taxman 373 (SC) would be of much relevance:

> *"120. The principles adopted in interpretation of treaties are not the same as those in interpretation of statutory legislation. While commenting on the interpretation of a treaty imported into a municipal law, Francis Bennion observes:*
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> > *"With indirect enactment, instead of the substantive legislation taking the well-known form of an Act of Parliament, it has the form of a treaty. In other words the form and language found suitable for embodying an international agreement become, at the stroke of a pen, also the form and language of a municipal legislative instrument. It is rather like saying that, by Act of Parliament, a woman shall be a man. Inconveniences may ensue. One inconvenience is that the interpreter is likely to be required to cope with disorganised composition instead of precision drafting. The drafting of treaties is notoriously sloppy usually for very good reason. To get agreement, politic uncertainty is called for.*
> >
> > *.....The interpretation of a treaty imported into municipal law by indirect enactment was described by Lord Wilberforce as being 'unconstrained by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptation. This echoes the optimistic dictum of Lord Widgery CJ that the words 'are to be given their general meaning, general to lawyer and layman alike... the meaning of the diplomat rather than the lawyer."*
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> *121. An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including (Mashreq Bank Psc.) one for double taxation relief, is that treaties are negotiated and entered into at a political level and have several considerations as their bases. Commenting on this aspect of the matter, David R. Davis in Principles of International Double Taxation Relief, points out that the main function of a Double Taxation Avoidance Treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. It is observed (vide para 1.06):*
>
> > *"The benefits and detriments of a double tax treaty will probably only be truly reciprocal where the flow of trade and investment between treaty partners is generally in balance.*

Where this is not the case, the benefits of the treaty may be weighted more in favour of one treaty partner than the other, even though the provisions of the treaty are expressed in reciprocal terms. This has been identified as occurring in relation to tax treaties between developed and developing countries, where the flow of trade and investment is largely one way.

Because treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient quid pro quo is obtained by both sides."

And, finally, in paragraph 1.08:

"Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally."

Based on these observations, counsel for the appellants contended that the preamble of the Indo-Mauritius DTAC recites that it is for the "encouragement of mutual trade and investment" and this aspect of the matter cannot be lost sight of while interpreting the treaty.

122. Many developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues. Moreover, several of them allow the use of their treaty network to attract foreign enterprises and offshore activities. Some of them favour treaty shopping for outbound investment to reduce the foreign taxes of their tax residents but dislike their own loss of tax revenues on inbound investment or trade of non-residents. In developing countries, treaty shopping is often regarded as a tax incentive to attract scarce foreign capital or technology. They are able to grant tax concessions exclusively to foreign investors over and above the domestic tax law provisions. In this respect, it does not differ much from other similar tax incentives given by them, such as tax holidays, grants, etc.

123. Developing countries need foreign investments, and the treaty shopping opportunities can be an additional factor to attract them. The use of Cyprus as a treaty haven has helped capital inflows into eastern Europe. Madeira (Portugal) is attractive for investments into the European Union. Singapore is developing itself as a base for investments in South East Asia and China. Mauritius today provides a suitable treaty conduit for South Asia and South Africa. In recent

years, India has been the beneficiary of significant foreign funds through the "Mauritius conduit". Although the Indian economic reforms since 1991 permitted such capital transfers, the amount would have been much lower without the India-Mauritius tax treaty.

124. Overall, countries need to take, and do take, a holistic view. The developing countries allow treaty shopping to encourage capital and technology inflows, which developed countries are keen to provide to them. The loss of tax revenues could be insignificant compared to the other non-tax benefits to their economy. Many of them do not appear to be too concerned unless the revenue losses are significant compared to the other tax and non-tax benefits from the treaty, or the treaty shopping leads to other tax abuses.

125. There are many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy, in the interest of long term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so called 'abuse' of 'treaty shopping', perhaps, it may have been intended at the time when Indo-Mauritius DTAC was entered into. Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations. This Court cannot judge the legality of treaty shopping merely because one section of thought considers it improper. A holistic view has to be taken to adjudge what is perhaps regarded in contemporary thinking as a necessary evil in a developing economy."

26. As observed by the Hon'ble Apex Court, while interpreting the provisions of bilateral treaties between two sovereign nations, it has to be borne in mind that Treaties are negotiated and entered at political level and have several considerations as their base. A bilateral treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling

to be taxed in both jurisdictions. Even, Article 31(1) of the Vienna Convention Law Treaties says that a treaty shall be interpreted in good faith in accordance with the terms of the treaty in their context and in the light of its object and purpose. Had the treaty partners intended to apply the restrictions of domestic law to Article 7(3) of the treaty, they would have specifically brought in such restrictive covenant in Article 7(3) itself from the very inception. In this context, the observations made by the Hon'ble Apex Court in paragraphs 123, 124 and 125, as reproduced above, makes interesting reading. Hon'ble Court has observed, at the time of entering into bilateral agreement, treaty partners permit treaty shopping to encourage capital and technology inflows, unless, the revenue losses are significant compared to other tax and non-tax benefits from the treaty or the treaty shopping leads to other unintended tax abuses. Even, accepting that there is some amount of treaty shopping, which may have taken place when the bilateral agreement was entered into, however, whether it should continue and if so for how long, is a matter which is best left to the discretion of the executive, as, it is dependent upon several economic and political considerations. Therefore, the provision contained in a Tax Treaty has to be

understood by strictly looking at the language used in the provisions contained therein.

27. The language of Article 7(3) of the Treaty, as it existed prior to its amendment by way of Protocol, makes it clear that there was nothing in the provision to infer that restrictions/conditions imposed in the domestic law, including section 44C, would be applicable while allowing deduction of expenses attributable to the PE. However, the situation stands substantially altered after amendment of Article 7(3), as, specific restriction has been imposed by providing for allowance of deduction in accordance with the provisions of the domestic laws of the State where the PE is situated. The language used in Article 7(3) of the treaty prior to and post amendment demonstrates that at the time of entering into the DTAA, the treaty partners, initially, never intended to put any restriction of the domestic laws on allowability of expenses in computing the business profits of the PE. Subsequently, the treaty partners having felt that the benefits provided under Article 7(3) needs to be withdrawn or restricted, agreed to amend the provision. Thus, in our view, prior to amendment of Article 7(3), the understanding between treaty partners is to allow all

expenses attributable to the PE, without applying the limitation/restriction imposed under the domestic laws.

28. Having held so, the next issue which arises for consideration is, whether the amendment brought to Article 7(3) by way of protocol will apply retrospectively. As stated earlier, the protocol amending Article 7(3) was specifically made effective from 01.04.2008. Therefore, it is very much clear, treaty partners intended to apply the amendment prospectively. Had the Treaty partners wanted the amendment to apply retrospectively, they would have specifically provided such retrospective operation. Hence, in absence of any such retrospective effect being given, such intendment cannot be inferred. In this context, it is relevant to examine provisions akin to Article 7(3) in various other tax treaties entered by India.

29. On a comparative analysis of identical provisions, like Article 7(3), in various Treaties, it is interesting to note, in treaties entered by India with UAE, France, Mauritius and Japan, Article 7(3) in its original form provided for deduction of expenses attributable to the PE without imposing restrictions of domestic laws. Whereas, in treaties entered with UK and Germany, the treaty partners intended to apply the restrictions of domestic laws

of the State wherein the PE is situated, in so far as, it relates to deduction of expenses on computing the profits of the PE. It is relevant to observe, the Treaty with France has been amended subsequently to apply the limitations of domestic laws. Thus, a comparative analysis of Treaties entered by India with various countries would make it clear, wherever the countries intended to apply the restrictions imposed in the domestic laws, it was specifically provided in the Treaty. Further, wherever the treaty partners intended to amend the provisions of the treaty retrospectively, they specifically provided for it.

30. Thus, the aforesaid factual and legal position make it clear that the conditions imposed in Tax Treaties are specific to each Treaty, as, a Bilateral Treaty is entered between two countries on the basis of negotiations and consideration of both commercial and political factors. Therefore, a provision of the Treaty has to be interpreted strictly in accordance with the language used therein. When the treaty partners wanted to change the provisions of the Treaty, again, it was based on negotiations/agreement and amendment was made with reference to a particular date. Therefore, the amendment would also apply from the effective date and not any other date. Since, the protocol amending Article

7(3) was made effective from 1st April, 2008, it will not have any retrospective effect. Therefore, going by the language used in Article 7(3), as it existed prior to its amendment by protocol dated 28.11.2007, the deduction of expenses attributable to the PE has to be allowed fully without applying the restrictions imposed under section 44C of the Act. It will be pertinent to observe, in case of ABN Amro Bank (supra), Special Bench of the Tribunal, while interpreting the provisions contained under Article 7(3) of India – Japan Treaty in contrast to similar provision in India – Netherland Treaty, observed that India – Japan Treaty does not provide for restriction in limit of expenditure as per domestic law provision. Thus, keeping in view the discussions, hereinabove, we hold that Article 7(3) of the Treaty, being an express provision contrary to the domestic law will, override the domestic law. As per the language of pre-amended Article 7(3) of the Treaty, the disallowance of expenditure attributable to the PE has to be allowed in full without applying the restriction imposed under section 44C of the Act. Thus, we agree with the view expressed by the Coordinate Benches in case of Dalma Energy LLC (supra), Abu Dhabi Commercial Bank (supra), State Bank of Mauritius Ltd (surpa) and the other decisions expressing similar view. At

this stage, we must observe, learned counsel of the Revenue had strongly relied upon a decision of the Canadian court in case of Utah Mines Vs The Queen [92 DTC 6194]. Having gone through the decision we are of the view that it was decided upon different set of facts, hence, not applicable. Firstly, in the case before us, there is no allegation by the Departmental Authorities that the non-resident assessee is getting a more favorable treatment than the resident assessee's. Secondly, while computing profit of business and profession, business expenses are allowed to a resident assessee under the Indian Income Tax Act. Accordingly, ground no.1 is decided in favour of the assessee.

31. Ground no. 4 relates to allowability of certain expenses exclusively incurred for the Indian branches outside India. In view of our decision qua ground no. 1, supra, separate adjudication of this ground was not necessary, as, the expenditure will have to be allowed under Article 7(3) of the Treaty, being expenditure of the PE. However, considering the fact that parties were heard at length on this issue as well, for the sake of completeness, we deem it appropriate to address the issue.

32. Having considered rival submissions, we find, the disputed expenses are-(i) SWIFT expenses of Rs. 1,68,349.17, and (ii) Globus Accounting Software expenses of Rs. 1,90,072.08. As far as factual aspect of the issue is concerned, there is no dispute that such expenses are incurred outside India exclusively for Indian branches. While, SWIFT expenses are charged to Indian operations on actual usage basis, Globus Accounting Software Maintenance expenses are charged to Indian operations on number of users' basis. The issue arising for consideration is, whether the provisions of section 44C would apply to such expenditure.

33. Looking at the nature of expenditure incurred, there cannot be any doubt that they are exclusively related to the operations of Indian branches. Whereas, section 44C speaks of head office expenditure. The expression 'head office expenditure' has been defined in clause (iv) of Explanation to section 44C as under:-

> "(iv) "head office expenditure" means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of-
>
> (a) rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;
>
> (b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India:
>
> (c) travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and

(d) such other matters connected with executive and general administration as may be prescribed."

34. As could be seen from the aforesaid definition, head office expenditure broadly means executive and general expenditure incurred by the non-resident assessee outside India. In circular no. 649 dated 31.02.1993 issued in the context of section 44C of the Act, the CBDT has clarified that expenditure not covered under section 44C of the Act are to be allowed without any limit while computing the business profits of the branch office. In case of CIT Vs. M/s. Emirates Commercial Bank Ltd. Vs. (Civil Appeal No. 1527 of 2006, dated 26th August, 2008), the Hon'ble Supreme Court upheld the decision of Hon'ble Bombay High Court, wherein, it was held that section 44C contemplates allocation of expenses amongst various entities. The expenditure covered under section 44C is of common nature, which is incurred for various branches or which is incurred for the head office and branches. In case of DIT Vs Credit Agricole Indosuez, [2016] 69 taxmann.com 285, the Hon'ble Bombay High Court has held that expenses incurred by head office on behalf of Indian branch are deductible under section 37(1) of the Act without applying the restrictions of section 44C of the Act. Same view was expressed by the Hon'ble Bombay High Court again in case of American

Express Bank Ltd. (ITA No. 1294 of 2013). The ratio that can be deduced from these decisions are, the expenditure specifically incurred for the branches has to be allowed without the restrictions of section 44C. Thus, keeping in view the definition of head office expenditure under section 44C and the ratio laid down in the judicial precedents, discussed above, we hold that the expenditure incurred outside India exclusively for the Indian branches does not fall within the ambit of section 44C. Hence, would be allowable in full. This ground is allowed.

35. In the result, the appeal is allowed, as indicated above.

Order pronounced in the open court on 06.02.2025

Sd/-	***Sd/-***	***Sd/-***
(PADMAVATHY S)	**(JUSTICE (RETD.) C V BHADANG)**	**(SAKTIJIT DEY)**
ACCOUNTANT MEMBER	**PRESIDENT**	**VICE PRESIDENT**

मुंबई Mumbai; दिनांक Dated: 06.02.2025

आदेश प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**