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TAX FLASH NEWS

17 November 2017

Amendment in the Income-tax Act does not affect the provisions of the tax treaties unless the same are included in the tax treaty

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Bank of India[1] (the taxpayer) held that any notification or circular[2] cannot alter the nature of income that has been specifically included in tax treaties. The tax authorities treated the business income and house property income as one source of income for tax purposes. However, India-Kenya tax treaty (tax treaty) contains two different Articles, i.e. 'business income' and 'house property income'. The Tribunal observed that even amendment in a Section of the Income-tax Act, 1961 (the Act) would not affect the provisions of tax treaties unless same are not ratified by both the signatories of the tax treaty. Accordingly, it was held that under Article 6 of the tax treaty house property income should be taxed in Kenya and not in India.

Facts of the case

- During the year under consideration, the taxpayer had received rent amounting to INR91.89 lakh. Out of the total rent credited, the taxpayer considered the rent of INR61.64 lakh for computing the income from house property in the original return. However, in the revised return the taxpayer declared a lower income of INR9.09 lakh from the house property.
- The Assessing Officer (AO) directed the taxpayer to reconcile the differences and to justify the lower income offered in the revised return. Subsequently, the AO held that the total rent received by the taxpayer during the year included an of INR75.06 lakh received by its foreign branches. The taxpayer offered the lower income in the revised return on account of the facts that the same was to be excluded from the Indian income, under the provisions of the tax treaty.
- The AO held that the exclusion of income could not be allowed. The AO held that the income of the taxpayer from house property had to be taxed at a figure shown in the original return. The AO held that income from house property located in Kenya could not be excluded. He referred to Notification No.91 of 2008 in that regard.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO, stating that notification did not allow the exclusion of such income.

Tribunal's decision

- The Tribunal perused Article 6 of the tax treaty. The taxpayer had excluded the house property income from computation as it was covered by the Article 6 of the tax treaty. However, the AO and the CIT(A) had treated the business income and house property income as one source of income for tax purposes. However, the tax treaty contains two different Articles. Business income is governed by Article 7 and Article 6 deals with house property income. Secondly, any notification or circular cannot alter the nature of income that has been specifically included in tax treaties.

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[1] DCIT v. Bank of India (ITA No. 3082/Mum/2015) – Taxsutra.com
Note – the Mumbai Tribunal in this decision has dealt with various other issues as well. However, we have prepared a flash news only on the issue of 'exclusion of income from house property at Kenya'

[2] Issued by the Central Board of Direct Taxes (CBDT)

- The Tribunal held that even amendment in a Section under the Act would not affect the provisions of tax treaties unless same are not ratified by both the signatories of the treaty. Accordingly, it has been held that house property income had to be taxed as per Article 6 of the tax treaty and as per that Article income from Kenyan house property could not be taxed in India. Reversing the order of the CIT(A), the Tribunal allowed the appeal of the taxpayer.

Our comments

Amendment introduced in the Act without corresponding amendment in a tax treaty has been a subject matter of debate before the Courts. Under the Act, the government has introduced several unilateral amendments. Some of the key amendments are as follows:

- Section 90(3) provides that if a term has not been defined under the Act as well as under the tax treaty, the government may assign the meaning by issuing notification.

- Section 206AA provides for deduction of tax at a higher rate when the taxpayer is not having PAN, even if tax treaty rate is beneficial to him.

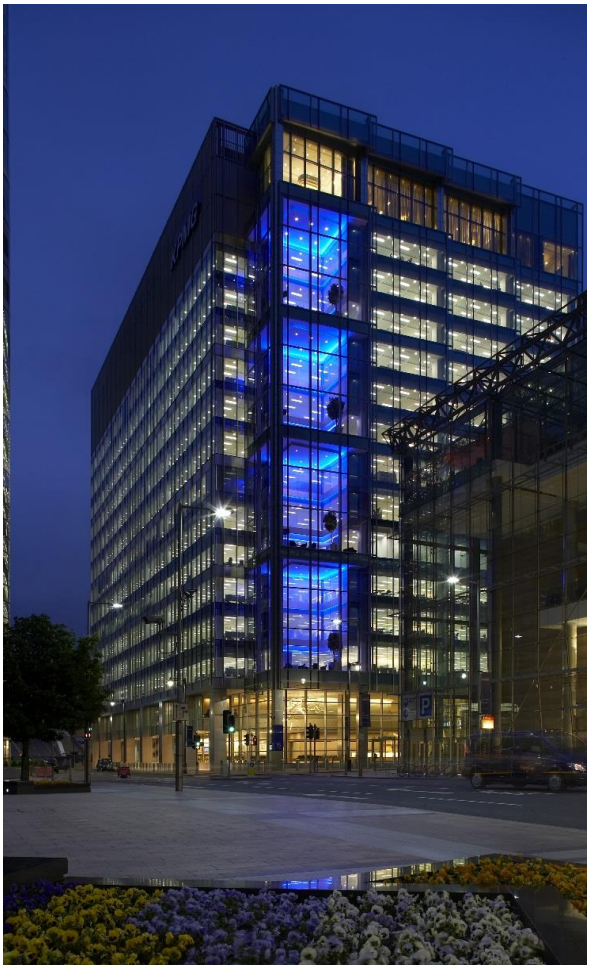
- Section 90(2A) provides that provisions of the General Anti Avoidance Rules (GAAR) will apply even if such provisions are not beneficial to him.

Under the international law, it is a well-established principle that bilateral tax treaties will have preference over a domestic law which is also stated in the Vienna Convention on Law of Treaties. Article 26 of the Vienna Convention states that *"Every treaty in force is binding upon the parties to it and must be performed by them in good faith".* A country may not invoke the provisions of its domestic law as a justification for its failure to perform a treaty.

The Supreme Court in various cases[3] has held that the provisions made in the tax treaties will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.

The Delhi High Court in the case of New Skies Satellite BV and Anr.[4] held that amendments made in the Act cannot be extended to a tax treaty between India and another nation and consequently, although the Act was amended, taxpayers were entitled to claim beneficial treatment under the tax treaty by virtue of Section 90 of the Act. Similarly, the Andhra Pradesh High Court, in the case of Sanofi Pasteur Holding SA[5] held that the amendments made in the Act do not nullify the tax treaties. The amendments made in the Act do not override the provisions contained in the tax treaty and, therefore, even after the amendments, the transaction which is governed by the tax treaty may not be liable to tax in India.

The Mumbai Tribunal in the present case has held that amendment in the Act would not affect the provisions of tax treaties unless same are not ratified by both the signatories of the treaty. Any notification or circular cannot alter the nature of income that has been specifically included in tax treaties.



[3] Azadi Bachao Andolan v. UOI [2003] 263 ITR 706 (SC), CIT v. P.V.A.L. Kulandagan Chettiar [2004] 137 Taxman 460 (SC)
[4] DIT v. New Skies Satellite BV and Anr. [2016] 382 ITR 114 (Del)
[5] Sanofi Pasteur Holding SA v. Dept of Revenue [2013] 354 ITR 316 (AP)

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