



Even for the period prior to the amendment to the India-UAE tax treaty, the allowance of head office expenditure is to be considered under the Income-tax Act

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Mashreq Bank PSC¹ (the taxpayer) while dealing with the issue of allowance of head office expenditure under the pre-amended² India-UAE tax treaty (the tax treaty) observed that the provisions of the tax treaty are specific and there is no ambiguity on the question of applicability of domestic tax laws. Since a specific provision³ exists in the tax treaty, the limitations on deduction of expenditure under the domestic tax laws cannot be ignored. Therefore, expenditure incurred for the purpose of the business including the executive and administrative expenditure are to be restricted to 5 per cent as prescribed under Section 44C of the Income-tax Act, 1961 (the Act).

Facts of the case

- The taxpayer is a banking company incorporated in the United Arab Emirates (UAE). The taxpayer is carrying on business in India through its branches in New Delhi and Mumbai.

- During the Assessment Year (AY) 2002-03, the taxpayer has not claimed deduction under Section 44C of the Act, since there was no profit in the current year. However, the taxpayer in a note appended to the income-tax return stated his/her claim of deduction of expenses. The taxpayer claimed that all expenses incurred for the purpose of the business including the executive and administration expenses are allowable without applying the limit of 5 per cent prescribed in Section 44C of the Act.
- The Assessing Officer (AO) rejected the claim of the taxpayer. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's ruling

- This issue had come up for consideration before the Tribunal, in the taxpayer's case⁴ for the AY 1996-97 and it was decided against the taxpayer. The Tribunal had held that the provisions of the tax treaty are specific and there is no ambiguity on the question of applicability of domestic tax laws in the absence of specific provisions to the contrary under the

¹ Mashreq Bank PSC v. DDIT (ITA No. 1342/Mum/2006) – Taxsutra.com

² India-UAE tax treaty is amended with effect from 1 April 2008

³ Article 25(1) of the tax treaty - The laws in force in either of the contracting states shall continue to govern the taxation of income and capital in the respective contracting states except where express provisions to the contrary are made in this Agreement.

⁴ Mashreq Bank v. JDIT [2007] 14 SOT 1 (Mum)

tax treaty. In a situation where a specific provision like Article 25(1) exists in the tax treaty, there cannot be any occasion to ignore the limitations on deduction of expenses under the domestic tax legislation.

- Further, the Tribunal in that case also held that unless there is a specific provision to the effect that restrictions under domestic tax laws on deduction of expenses are to be ignored, the same will have application in the computation of Permanent Establishment profits under Article 7(3) of the tax treaty.
- A protocol⁵, amending the tax treaty had two major changes. One of the changes is with respect to the restrictions under the domestic tax law specifically extending to the computation of taxable profits under Article 7 of the tax treaty. In effect thus, the protocol made the legal provision, with respect to tax liability in UAE not being *the sine qua non* to avail the treaty benefits in India, unambiguous and without any doubt. What was implicit in the tax treaty earlier was made explicit by the protocol later. That is the view the coordinate benches have been taking consistently all along. The Bombay High Court in the case of ICICI Bank⁶ also approved the decision so taken, for the pre 1 April 2008 period.
- When this issue came up before the Ahmedabad Tribunal in the case of Dalmas Energy LLC⁷, the earlier decision in the case of Mashreq Bank's decision was not brought to the notice of the coordinate bench. The Ahmedabad Tribunal did not have the benefit of knowing that even without the assistance of the protocol amendment, the Mumbai Tribunal had come to the conclusion that the limitations of domestic law in computing profit under Article 7 were implicit by the virtue of Article 25(1) of the tax treaty. The Ahmedabad Tribunal held that the domestic law limitations on deductions were applicable only with effect from 1 April 2008 i.e. after entering into the protocol.

- In the light of the settled legal position laid down by the decision of Andhra Pradesh High Court⁸, the decision of Dalmas Energy LLC lacks precedence value for the simple reason that the bench had no occasion to deal with, or take into account, an earlier binding decision on the same issue.
- In the case of Abu Dhabi Commercial Bank Ltd⁹ also, the coordinate bench did take note of the Mashreq Bank decision. However, the coordinate bench was of the view that the decision of Mashreq Bank stands 'impliedly' overruled by a five member bench of Mumbai Tribunal in the case of Sumitomo Mitsui Banking Corporation Ltd¹⁰. The coordinate bench thus ignored the Mashreq Bank decision and followed that of Dalmas Energy LLC and held that the domestic law limitations on deductions are applicable only with effect from 1 April 2008.
- It needs to bear in mind the fact that a judicial precedent holds good for what is decided by the judicial precedent and not what follows from the same. The jurisdictional High Court, in the case of Sudhir Jayantilal Mulji¹¹ held that it is well-settled that the ratio of a decision alone is binding because a case is only an authority for what it actually decides and not what may come to follow from some observations which find place therein. Therefore, a judicial precedent holds good in law as long as it is not specifically reversed or disapproved at a higher judicial forum and as long as a higher judicial forum has not held anything directly and clearly contrary to the *ratio decidendi* of the said judicial precedent, unless, such a judicial precedent itself is held to be per incurium on the basis of the well settled legal principles.

⁵ Notification No. 282 of 2007, dated 28 November 2007

⁶ DIT v. ICICI Bank Limited [2015] 370 ITR 17 (Bom)

⁷ ADIT v. Dalmas Energy LLC [2012] 150 TTJ 70 (Ahd)

⁸ CIT v. B R Constructions [1993] 202 ITR 222 (AP FC)

⁹ Abu Dhabi Commercial Bank Ltd v. ADIT [2012] 23 taxmann.com 359 (Mum)

¹⁰ Sumitomo Mitsui Banking Corporation Ltd v. DDIT [2012] 136 ITD SB 66 (Mum)

¹¹ CIT v. Sudhir Jayantilal Mulji [1995] 214 ITR 154 (Bom)

- The observations made in the Abu Dhabi Commercial Bank's decision to overrule the Mashreq Bank decision is without any basis. These observations were made in the context of taxation of income. The five member bench decision in the case of Sumitomo Mitsui Banking Corporation Ltd. was in the context of taxability of interest income received from various units of the taxpayer bank itself, whereas the Mashreq Bank decision was in the context of admissibility of disallowances under the Act in computation of income under Article 7 when there are no specific contrary provisions in the treaty. The observations made by the five member bench cannot be considered to be reversing, disapproving or even dealing with the *ratio decidendi* of the Mashreq Bank's decision.
- The concept of a binding precedent being 'implied overruled' is a myth. A binding precedent is either overruled by another precedent from the higher forum, or it is not overruled. The concept of a binding precedent being 'impliedly overruled', would amount to rejecting a binding precedent on the basis of what logically follows from another binding precedent of a higher forum, but then such a process of rejecting the judicial precedents is contrary to the principles laid down by the High Court in the case of Sudhir Jayantilal Mulji.
- On a conceptual note, every specific amendment to the law or a tax treaty, particularly when it is disadvantageous to the taxpayers and is enacted *ex abundanti cautela* (as a measure of abundant caution) is generally, fraught with, what tax academicians and policymakers term as, the risk of its 'kill effect'. The risk is that when a specific provision, to make things clear and beyond any doubt, is enacted with respect to a particular point of time and a particular consequence is envisaged by the provision, interpretation of the law or treaty will invariably be inclined to draw to the inference that no such consequence was envisaged by the legislature or the treaty prior to the amendment coming into force.
- The issue is squarely covered by the decision of the Mumbai Tribunal, in the taxpayer's own case for the AY 1996-97. This stand has now been specifically accepted in the protocol to the tax treaty.
- The Tribunal has not referred the matter to a Special Bench Tribunal because the Abu Dhabi Commercial Bank's decision itself follows a decision in the case of Dalmas Energy LLC. Though inadvertently it was never brought to the notice of the bench, and it ignored the earlier binding precedent, and was thus *per incuriam*, and adopted an approach which was contrary to the law laid down by the jurisdictional High Court in the case of Sudhir Jayantilal Mulji. The approach adopted by the Special Bench Mumbai Tribunal is in conflict with the law laid down by the jurisdictional High Court and also by a full bench of Andhra Pradesh High Court in the case of BR Constructions.
- If at all the subsequent bench had doubts on the correctness of these views, the matter could have been referred to a Special Bench but that course was not adopted. However, because of this deviation and particularly as the High Court did not have doubts about the correctness of its approach which is also adopted in a large number of judicial precedents and which now has the approval of the jurisdictional High Court, the Tribunal had not referred this issue to a Special Bench.
- This issue is also now pending before the Bombay High Court. The multiplicity of proceedings before various forums and at this stage cannot serve any meaningful purpose. The constitution of a Special Bench would not have been appropriate for this reason as well.
- Accordingly, the Tribunal upheld the order of the CIT(A). The claim made by the taxpayer by way of note to the income tax return is rejected. As the taxpayer had incurred a loss during the year, no part of head office expenses is allowable under Section 44C of the Act. As the taxpayer had not anyway claimed any deduction in the income tax return in this respect, no disallowance is warranted.

Our comments

The Tribunal in the present case while dealing with the issue of allowability of head office expenditure under the India-UAE tax treaty held that expenditure incurred for the purpose of the business including the executive and administrative expenditure are to be restricted to 5 per cent as prescribed under Section 44C of the Act.

On the issue of 'binding precedent', the Tribunal relying on the decision of Bombay High Court in the case of Sudhir Jayantilal Mulji, observed that a judicial precedent holds good in law as long as it is not specifically reversed or disapproved at a higher judicial forum and as long as a higher judicial forum has not held anything directly and clearly contrary to the *ratio decidendi* of the said judicial precedent.



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