

CASE NO.:
Appeal (civil) 5752 of 1997

PETITIONER:
COMMISSIONER OF INCOME TAX

RESPONDENT:
P.V.A.L. KULANDAGAN CHETTIAR (DEAD) THROUGH LRS.

DATE OF JUDGMENT: 26/05/2004

BENCH:
S. RAJENDRA BABU CJ & G.P. MATHUR

JUDGMENT:
JUDGMENT

2004 Supp(2) SCR 697

The Judgment of the Court was delivered by

RAJENDRA BABU, CJ. : These appeals involve following two questions for our consideration although several other questions were considered by the High Court :

(a) Whether the Malaysian income cannot be subjected to tax in India in the basis of the agreement of avoidance of double taxation entered into between Government of India and Government of Malaysia?

(b) Whether the capital gains should be taxable only in the country in which the assets are situated?

The facts leading to these appeals are that the respondent is a firm owning immovable properties at Ipoh, Malaysia; that during the course of the assessment year the assessee earned income of Rs. 88,424 from rubber estates; that the respondent sold property, the short term capital gains of which came to Rs. 18,113; that the Income Tax Officer assessed that both the incomes are assessable in India and brought the same to tax; that the respondent filed an appeal before the Commissioner of Income Tax (Appeals) who held that under Article 7(1) of the Avoidance of Double Taxation of Income and Prevention of fiscal Evasion of Tax unless the respondent has a permanent establishment of the business in India such business income in Malaysia cannot be included in the total income of the assessee and, therefore, no part of the capital gains arising to the respondent in the foreign country could be taxed in India.

This order was carried in appeal to the Tribunal. The Tribunal, after examining various contentions raised before it, confirmed the order of the Commissioner of Income Tax (Appeals) and held that (i) since the respondent has no permanent establishment for business in India, the business income in Malaysia cannot be included in his income in India, and (ii) the property is situated in Malaysia, capital gains cannot be taxed in India. Thereafter, the matter was carried by way of a reference to the High Court.

The High Court held that the finding of the Tribunal is in accordance with the provisions of the Avoidance of Double Taxation of income. The High Court took the view that :

(i) where there exists a provision to the contrary in the agreement, there is no scope for applying the law of any one of the respective contracting States to tax the income and the liability to tax has to be worked out in the manner and to the extent permitted or allowed under the terms of the agreement.

(ii) if there is no specific provision, the local tax law governing the

levy of income tax in the respective States shall be applicable and if in the course of such application, assessment and determination of the tax liability double taxation results or has been brought about of the entirety of the particular category of income in both countries, than the tax credit or relief contemplated in the other provision of Article XXII would get attracted and have to be applied.

(iii) In respect of some categories of income total exemption or elimination is not contemplated and in certain other cases, the exemption depends upon the fulfilment of certain conditions and in all such cases, the exemption depends upon the fulfilment of certain conditions and in all such cases only tax credit or relief can only be accorded to the extent permissible under the various provisions of the agreement in order to avoid double taxation.

(iv) The stand taken by the Revenue that for rate purposes and the determination of the total income derived from a source in Malaysia shall first be taken into consideration in computation does not merit acceptance and allowing the Department to do so would amount to permitting flagrant violation of law as also the agreement entered into in these cases with the Government of Malaysia.

(v) The contention urged on behalf of the Revenue that wherever the enabling words such as "may be taxed" are used there is no prohibition or embargo upon the authorities exercising powers under the Indian Income Tax Act, 1961 from assessing the category or class of income concerned cannot be accepted as of substance or merit.

(vi) The High Court rejected the application of commentaries on the Article of the Model Convention of 1977 presented by the Organisation for Economic Co-operation and Development (for short 'OECD') as it would not be a safe or acceptable guide or aid for such construction.

(vii) Disposal of the property or the capital asset itself is as much a form or method of use of the immovable property as such, and the words 'direct use.....or use in any other form' are sufficiently wide enough to include within its scope the transfer, sale or taxcharge of the property.

(viii) The provision of Article VI alone would apply and govern the assessment of capital gains also derived from the immovable property situated at Malaysia.

Before we embark upon the examination of contentions raised in these cases, we shall briefly notice the legal position in regard to the provisions relating to double taxation and the reliefs granted therein.

The traditional view in regard to the concept of 'double taxation' is that to constitute double taxation, objectionable or prohibited, the two or more taxes must be (1) imposed on the same property, (2) by the same State or Government, (3) during the same taxing period, and (4) for the same purpose. There is no double taxation strictly speaking where (a) the taxes are imposed by different States, (b) one of the impositions is not a tax, (c) one tax is against property and the other is not a property tax or (d) the double taxation is indirect rather than direct.

But, we have travelled very far from this stage as the Indian law has developed in this regard. Section 90 of the Indian Income Act, 1961 (hereinafter referred to as 'the Act') provides for "Agreement with foreign countries" in cases where (a) for granting of relief in respect of income on which have been paid both income-tax under the Act and income tax in that country, or (b) for the avoidance of double taxation of income under the Act and under the corresponding law in force in that country, or (c)

for exchange of information for the prevention of evasion or avoidance of income tax chargeable under the Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or (d) for recovery of income tax under the Act and under the corresponding law in force in that country. But virtue of provisions of subsection (2) thereof it is provided that where such agreement has been entered into for granting relief of tax, or as the case may be, avoidance of double taxation, then in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

Where liability to tax arises under the local enactment provisions of Sections 4 and 5 of the Act provide for taxation of global income of an assessee chargeable to tax thereunder is subject to the provisions of an agreement entered into between the Central Government and Government of a foreign country for avoidance of double taxation as envisaged under Section 90 to the contrary, if any, and such an agreement will act as an exception to or modification of Sections 4 and 5 of Income Tax Act. The provisions of such agreement cannot fasten a tax liability where the liability is not imposed by a local Act. Where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the provisions of the Act, as is clear from the provisions of Section 90(2) of the Act. Section 90(2) makes it clear that "where the Central Government has entered into an agreement with the Government of any country outside India for granting relief of tax, or for avoidance of double taxation, then in relation to the assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to that assessee" meaning thereby that the Act gets modified in regard to the assessee in so far as the agreement is concerned if it falls within the category stated therein.

The learned Attorney General urged that an agreement can give different types of reliefs either by way of 'avoidance' or by way of 'credit' to eliminate double taxation; that 'credit' method as well as 'avoidance' method will have to be decided with reference to the provisions in the agreement; that wherever the expression used in the treaty is "income shall be taxable only in " or "shall not be taxed in " or "shall be exempt from tax in ", what is contemplated is the avoidance method; that, on the other hand, whenever the expression used is "income may be taxed" what is contemplated is the relief or the credit method; that Article XXI(2) of the Indo-Malaysian Treaty also indicates that the said Treaty contemplated the credit method. He submitted that Article XXII(2) is not a residuary Article in respect of forms of income not otherwise specified in the Treaty; that whenever it was intended that there should be a residuary clause, it has been specifically so provided in various other Treaties, most Treaties, including the OECD Model Treaty and the Indo-Mauritius Treaty, have specific residuary clauses in addition to the Article XXI(2) where it is stated that subject to the provisions of paragraph 2 of Article XXII items of income of a resident of a Contracting State, wherever, arising, which are not expressly dealt with the foregoing articles of this Convention, shall be taxable only in that Contracting State. Therefore, he submitted that if the said Article XXII(2) was meant to operate as a residuary clause covering heads of income not specifically mentioned, there was no need for such a specific Article in the other Treaties; that Article XXII(2) of the Indo-Malaysian Treaty itself makes it clear that it applies only when tax is payable "in accordance with the provisions of this Agreement" which means it applies only where tax is payable in accordance with or is relatable to one of the Articles of the Agreement. He refuted the contention that the Treaty would be meaningless and would serve no purpose since this contention overlooks the basic fact that under section 91(1) the assessee can seek relief only if he provides that he had paid tax

in the other country and on the other hand, under Article XXII(2) of the Treaty relief is available whenever tax is payable under the laws of Malaysia; that the words "tax actually paid" and "tax payable" are two different concepts; that, in this context, this Court in 263 ITR 706 recognised this aspect of the matter. He further urged that tax on capital gains is a different kind of tax though brought within the fold of income tax law in this country; that under the principles of international law the fiscal jurisdiction of a State to tax any form of income generally arises from either the location of the source of income within its territory or by virtue of the residence of the assessee within its territory. However, in contrast to the State where income is sourced, the country of residence is entitled to tax the assessee on its global income and in other words, the assessee is subject to unlimited liability in the State of residence. Similar view has been taken by Karnataka High Court in 202 ITR 508. Thus, the State of which the assessee is a resident has inherent jurisdiction to tax the assessee's income from property situated in another State. However, since it is generally recognised that the State of source in respect of immovable property has a closer economic connection with the income from that property, the Treaties generally provide that tax which may be imposed by the State of source in respect of such property and shall be allowed as a credit in the State of residence; that it needs to be emphasised that there is no bar under the international law for the State of residence to impose tax on income from property situated in another State and whether there is such a bar under the Treaty depends upon the correct interpretation of its provisions.

So far as business income is concerned, the learned Attorney general submitted that the argument that income attributable to a permanent establishment is taxable only in the State where the permanent establishment is situated is incorrect; that even in the case of business income the power to tax given to Malaysia is in permissive language, that is, 'may' and it is therefore not correct to contend that in such a case tax can be imposed only by Malaysia; that there is no dispute that the assessee is a resident and enterprise of India and in such a situation a reading of Article 7(1) makes it clear that ordinarily income of an Indian enterprise shall be taxable only in India unless the enterprise carries on business in Malaysia through a permanent establishment situated therein in which case tax may be imposed in Malaysia though only to the extent of income attributable to that permanent establishment; that the Treaty in question employs different expressions in respect of different forms of income under different situations and there is intrinsic evidence in the Treaty that where the Treaty sought to bar the jurisdiction of one State in respect of a particular item of income it has said so expressly; that the argument of the respondent that the expression "may be taxed in" means "shall be taxed only in" a particular State is not permissible. He further contended that the Treaty does not confer power on any State to levy tax because the power to tax being derived from the domestic law of the respective States including the power to tax the global income of a resident; that thus, in the absence of a clear bar or exclusion of jurisdiction to levy tax by virtue of the Treaty, tax can always be imposed by either State under its domestic laws and a bar or embargo on the jurisdiction of a country to levy tax has to be express and cannot be read into a Treaty by implication; that, moreover, when a Treaty specifically employs different expressions such as "shall only be taxable" and "may be taxed" such expressions will necessarily have to be given different meanings. He further urged that in any event capital gains is not one of the aspects covered by the Treaty inasmuch as there is no specific provision under the Treaty providing for the treatment of such income and the High Court has sought to bring the same within the ambit of Article 6. Further, he contended that it may be noted that the scope of Article 6(1) is restricted by the words of Article 6(3) which provides that the provisions of the said Article shall apply only to income derived from the use of immovable property; that the expression 'capital gains' is a well defined concept and the taxable event is 'transfer' or 'alienation' of property and capital gains cannot arise from the use of property because 'transfer' and

'use' being different legal concepts since use of property postulates the continues existence of the property whereas on transfer of property, the property ceases to be the property of the owner. Therefore, he contended, capital gains is the profit arising from the transfer of the property as distinct from the profits arising from the use of the property.

On behalf of the respondents it is submitted that there is a distinction between the agreements for avoidance of double taxation of income falling under clause (b) of Section 91 of the Act and agreements for granting relief in respect of income on which tax has been paid in more than one country falling under clause (a) of that Section; that Articles 6 to 21 of the treaty must be read as providing for allotment of the taxing power to either India or Malaysia both of whom could otherwise have taxed the same income by virtue of tax payer being a resident of one of those countries or by virtue of the source of the income having arisen in one of those countries; that Article 6, therefore, allocates the power to tax income from immovable property in the contracting State in which such property is situated; that agreement of this nature between Governments representing sovereign nations necessarily implies surrender by each of the States to the other State of its taxing power over a particular income for their mutual benefit and for the benefit of their citizens. The respondents seek to distinguish the judgment of the Federal Court of Australia in *Chong v. Commissioner of Taxation*, (2000) FCA 635, on which reliance was placed by the learned Attorney General. The learned counsel appearing on behalf of the respondents adverted to the decisions in *Commissioner of Taxation v. Lamesa holdings BV*, (1997) 77 FCR 579. It is contended that income from the alienation of real property is allocated to the State in which that property is situated. The income in question in the present appeals in relation to business arises from the activities relating to rubber plantations which would clearly fall both within Article 6 and Article 7. Rubber plantations being immovable property even business income therefrom is admittedly derived from use of such property as contemplated in Article 6 and, therefore, it is submitted, in view of sub-article (6) of Article 7 this kind of income has to be taxed based on source of income in terms of Article 6. The learned counsel further submitted that in the respondent's own assessment prior to the assessment in appeal for the assessment year 1970-80 and for many subsequent year assessments have been finalised pursuant to the law laid down by the Karnataka High Court in *CIT v. R.M. Muthaiah*, (2000) ITR 508; that the parties have arranged their affairs and accounts have been finalised for more than three decades based on the understanding of the law and any change in law now after three decades would put them in great difficulty.

Shri T.L. Vishwanatha Iyar, learned senior Advocate appearing on behalf of the respondents in some of these appeals, submitted that Treaty in question came into force from the assessment year 1973-74 though the Treaty was signed in October 1976; that prior to 1973-74 the procedure adopted was to allow only tax credit on the income taxes both in India and Malaysia; that this procedure was found to be extremely difficult and cumbersome and the assesseees have to produce even for the purpose of claiming the tax credit not only the assessment orders passed by the concerned authorities in Malaysia but also the receipted tax paid challans evidencing payment of tax in Malaysia; that in the recent years, the Income Tax Authorities in Malaysia have dispensed with the procedure of issuing any assessment orders and even the taxes are paid directly into the Bank and this has resulted in there being no assessment order passed by these authorities in Malaysia or any receipted tax paid challans being issued; that this again resulted in considerable difficulty in the matter of completing the assessments in India. It is submitted that to avoid such difficulties experienced by the assesseees the Government of India and Malaysia entered into an Agreement for the "Avoidance of Double Taxation" between the two countries which in effect meant that the income arising in Malaysia was not to be included in the total income in India subject to certain conditions in the Articles of the Agreement; that, therefore, when the Treaty came into force the income tax authorities in India need not have to insist upon the production of the

assessment orders and the receipted tax paid challans and were, therefore, empowered to avoid the income arising in Malaysia; that thus such income arising in Malaysia subject to certain conditions was to be completely excluded from the total income in India. It is further contended that the question whether Section 5(c) of the Income Tax Act applies to a resident to whom the income arising in all parts of the world had to be included in the total income in India loses its effect the coming into force of the Treaty between the two countries; that circular dated April 2, 1982 was issued by the Central Board of Direct Taxes indicating that whenever there is conflict between the provisions of the Income Tax Act and the provisions of the Treaty only the provisions of the Treaty would prevail. Therefore, it was submitted that after the Treaty was signed by the two countries the Income Tax Act could no longer be the law governing the taxability of such income in the two countries but only the Treaty governs such taxability and thus the provisions of Section 4 or 5 or 6 of the Income Tax Act could no longer be looked into for this purpose. In regard to Article VI of the Treaty regarding taxability of income tax from immovable properties, it is urged on behalf of the respondents that the word 'may' would also mean in that context 'must' or 'shall' because the situs of the property has to be considered and if the situs of the property is situated in Malaysia, the income from the property can be assessed to tax only in that country and again under the provisions of the Treaty in question, such income cannot be included in the total income in India. Further, clause 3 of Article VI refers to income derived from the direct use, letting, or use in any other form of immovable property. Inasmuch as direct use could be used in any manner and the letting could be used by letting out the property, the use in any other form could only refer to capital gains since such use is made by the assessee till date of sale of the property and the capital gains is also an income arising out of that property. He submitted that for certain category of income capital gains is also income as per Section 2(24) of the Income Tax Act and the decision of the Karnataka High Court in 202 ITR 508 has accepted this kind of reasoning and since no appeal has been filed to this Court against the decision of the Karnataka High Court reported in 202 ITR 508, the law declared therein has been applicable to the assessee to whom treaty applies. In regard to Article VII relating to income from business, it is submitted, the importance has to be the place where the permanent establishment is situate and if the assessee earns business profits through a permanent establishment situate in Malaysia, such income could be said to arise only in Malaysia and such income cannot be included in the total income in India. The importance of Article XXII(2) of the Treaty is that it is applicable to income arising to an assessee other than those mentioned in Article VI to XXI of the Treaty and also a situation where any income that has not been referred to therein become taxable in either country at a much later date. He further argued that OECD model treaty came into existence only in the latter part of 1977, while the Treaty in question was signed in October 1976; that most of the clauses in the OECD model treaty could not have been in the contemplation of the parties at the time when the Treaty in question was signed and the provisions of OECD model treaty cannot, therefore, be applied to the Treaty in question. He further urged that Article XXII(2) will apply only when taxes are payable under the laws of Malaysia; that even for granting the tax credit, the proof of tax paid in Malaysia has to be furnished and it would thus be similarly necessary to furnish such proof of tax paid in Malaysia even for the purpose of Article XXII(2) of the Treaty; that in order to avoid conflicts of interest, the Treaty between India and Malaysia was signed and under the Articles of the Treaty the income arising in Malaysia has to be totally excluded while computing the income in India, subject to the conditions prescribed therein.

Agreement between the Government of India and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on income was entered into on 1.4.1977. This Agreement is applicable to persons who are resident of one or both of the contracting States. Under Article 11 taxes which are the subject of the Agreement are as follows :

IN MALAYSIA : (i) the income tax;

(ii) the supplementary income tax, that is, profits tax, development tax and timber profits tax; and

(iii) the petroleum income tax; IN INDIA

(i) the income tax and any surcharge on income tax imposed under the Income Tax Act, 1961 (43 of 1961);

(ii) the surtax imposed under Companies (Profits) Surtax Act, 1974 (7 of 1964)

This agreement also applies to any other taxes of a substantially similar character to those referred to in the preceding paragraph imposed in either contracting State after the date of signature of the Agreement in question. Articles IV, V, VI, VII and XXII of the Agreement read as under :

"ARTICLE IV Fiscal Domicile

1. In this Agreement, unless the context otherwise requires : (a) the term "resident of Malaysia" means

(i) an individual who is ordinarily resident in Malaysia; or

(ii) a person other than individual who is resident in Malaysia; for the basis year for a year of assessment for the purpose of Malaysian tax;

(a) the term "resident of India" means a person who is treated as a resident of India in the previous year for the relevant assessment year for the purpose of Income tax:

(b) the terms "resident of one of the Contracting States" and "resident of the other Contracting State" mean a resident of Malaysia or a resident of India, as the context requires.

2. Where by reason of the provisions of paragraph 1 of this Article an individual is a resident of both Contracting States, then his residential status be determined in accordance with the following rules :

(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer;

(b) if the Contracting State with which his personal and economic relations are closer cannot be determined, or if he has not a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;

(c) if he has an habitual abode in both Contracting States or in neither of them he shall be deemed to be a resident of the Contracting State of which he is a citizen;

(d) if he is a citizen of both Contracting State or of neither of them, the competent authorities of the Contracting States shall determine the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 of this Article a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective

management is situated.

ARTICLE V Permanent Establishment

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially :

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop;
- (f) a warehouse;
- (g) a mine, oil well, quarry or other place of extraction of natural resources;
- (h) a building site or construction, installation or assembly project which exists for more than six months;
- (i) a farm or plantation;
- (j) a place of extraction of timber or forest produce. (3) The term "permanent establishment" shall not be deemed to include

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise.

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery.

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which has a preparatory or auxiliary character, for the enterprise.

4. An enterprise of one of the Contracting States shall be deemed to have a permanent establishment in the other Contracting State if :

(a) it carries on supervisory activities in that other Contracting State for more than six months in connection with a construction, installation or assembly project which is being undertaken in that other Contracting State;

(b) it carries on a business which consists of providing the services of public entertainers (such as stage, motion picture, radio or television artistes and musicians) or athletes in that other Contracting State unless the enterprise is directly or indirectly supported, wholly or substantially, from the public funds of the Government of the first-

mentioned Contracting State in connection with the provision of such services.

5. Subject to the provisions of paragraph 6 of this Article, a person acting in one of the Contracting States on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment in the first-mentioned Contracting State if :

(a) he has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts on behalf of the enterprise unless his activities are limited to the purchase of goods or merchandise for the enterprise; or

(b) he maintains in the first-mentioned Contracting State a stock of goods or merchandise belonging to the enterprise from which he regularly fills orders on behalf of the enterprise.

6. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other Contracting State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of one of the Contracting States controls or is controlled by a company which is a resident of the other Contracting State or which carries on business in that other Contracting State whether through a permanent establishment or otherwise shall not of itself constitute either company a permanent establishment of the other:

CHAPTER III

TAXATION OF INCOME

ARTICLE VI

Income from Immovable Property

1. Income from immovable property may be taxed in the Contracting State in which such property is situated.

2. The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, oil wells, quarries and other places of extraction of natural resources or of timber or forest produce. Ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1, of this Article shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraph 1 and 3 of this Article shall also apply to the income from immovable property of an enterprise.

ARTICLE VII Business Profits

1. The income or profits of an enterprise of one of the Contracting States shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State though a

permanent establishment situated therein. If the enterprise carries on business as aforesaid, tax may be imposed in that other Contracting State on the income or profit of the enterprise but only on so much of that income or profit as is attributable to that permanent establishment.

2. Where an enterprise of one of the Contracting State carries on business in other Contracting State though a permanent establishment situated therein, there shall be in each Contracting State be attributed to that permanent establishment the income or profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the Income or profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes 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.

4. In so far as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total income or profits of the enterprise to its various parts, nothing in paragraph 2 or paragraph 3 of this Article shall preclude such Contracting State from determining the income or profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles laid down in this Article.

5. No income or profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the purpose of export to the enterprise of which it is the permanent establishment.

6. Where income or profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.

CHAPTER IV

ELIMINATION OF DOUBLE TAXATION ARTICLE XXII

1. The laws in force in either of the Contracting States will continue to govern the taxation of income in the respective Contracting States except where provisions to the contrary are made in this Agreement.

2. (a) The amount of Malaysian tax payable, under the laws of Malaysia, and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Malaysia, which has been subjected to tax both in India and Malaysia shall be allowed as a credit against the India tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax.

(b) For the purposes of the credit referred to in sub-paragraph (a) above, there shall be deemed to have been paid by the resident of India :

(i) the amount of tax which would have been paid in respect of royalties but for the exemption provided in paragraph 2 of Article 13; and

(ii) the amount of tax which would have been paid if the Malaysian tax had not been reduced or relieved in accordance with the special incentive means as designed to promote economic development in Malaysia -

(aa) which are set forth in section 21, 22 and 26 of the Investment Incentives Act, 1968 of Malaysia; or

(bb) which may be introduced in future in the Income Tax Act, 1967, Supplementary Income Tax Act, 1967, Petroleum (Income Tax) Act, 1967 or Investment Incentives Act, 1968 in modification of or in addition to the existing measures;

Provided an agreement is made between the two Contracting States in respect of the scope of the benefit accorded by the said measures.

3. (a) The amount of Indian tax payable, under the laws of India and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident of Malaysia, in respect of income from sources within India which has been subjected to tax both in India and Malaysia, shall be allowed as a credit against Malaysian tax payable in respect of such income, but in an amount not exceeding that proportion of Malaysian tax which such income bears to the entire income chargeable to Malaysian tax.

(b) For the purposes of the credit referred to it in sub-paragraph (a) above, there shall be deemed to have been paid by the resident of Malaysia the amount which would have been paid if the Indian tax had not been reduced or relieved in accordance with the special incentive measures designed to promote economic development in India -

(i) in relation to royalties, as set forth in the relevant annual Finance Act of India, and

(ii) in relation to other income as set forth in the following sections of the Income-tax Act, 1961 of India or which may be introduced in future in the India tax laws in modification of or in addition to the existing measures, provided that an agreement is made between the two Government in respect of the scope of the benefit accorded by the said measures :

(aa) Section 10(15)(iv)(b) and (c) - relating to exemption from tax of (a) an approved foreign financial institution in respect of interest on moneys lent by it to an industrial undertaking in India under a loan agreement; and (b) a non-resident in respect of interest on moneys lent or credit facilities allowed by him to an industrial undertaking in India for the purchase outside India of raw materials or capital plant and machinery;

(bb) Section 33 - relating to development rebate in respect of ships, machinery or plant;

(cc) Section 80-J - relating to deduction in respect of profits and gains from eligible industrial undertaking or ships or hotels;

(dd) Section 80-K - relating to deduction in respect of dividends attributable to profits and gains from eligible industrial undertakings or ships or hotels; and

(ee) Section 80-M - relating to deduction in respect of certain dividends received by a company from a domestic company. This sub-clause shall apply in relation to a company which is a resident of Malaysia only if such company beneficially holds shares (either singly or together with any company controlling it or any company controlled by it) carrying not less than ten per cent of the voting power in the domestic company and the domestic company is an industrial company.

(i) any other incentive measure as may be agreed from time to time between the two Contracting States."

Now, we shall first deal with the argument advanced on behalf of the Union of India by the learned Attorney General.

Here in these appeals we are concerned with income arising from immovable property. We will proceed on the basis that fiscal connection arises in relation to taxation either by reason of residence of the assessee or by reason of the location of the immovable property which is the source of income. In the clauses which we have set out above fiscal domicile is set out in Article IV which states that in a case where the person is a resident in both the contracting States fiscal domicile will have to be determined with reference to the fact that if the contracting State with which his personal and economic relations are closer he shall be deemed to be a resident of the contracting State in which he has an habitual abode. This implies that tax liability arises in respect of a person residing in both the contracting State has to be determined with reference to his close personal and economic relations with one or the other.

The immovable property in question is situated in Malaysia and income is derived from that property. Further, it has also been held as a matter of fact that there is no permanent establishment in India in regard to carrying on the business of rubber plantations in Malaysia out of which income is derived and that finding of fact has been recorded by all the authorities and affirmed by the High Court. We, therefore, do not propose to re-examine the question whether the finding is correct or not. Proceeding on that basis, we hold that business income out of rubber plantations cannot be taxed in India because of closer economic relations between the assessee and Malaysia in which the property is located and where the permanent establishment has been set up will determine the fiscal domicile. On the first issue, the view taken by the High Court is correct.

We need not to enter into an exercise in semantics as to whether the expression "may be" will mean allocation of power to tax or is only one of the options and it only grants power to tax in that State and unless tax is imposed and paid no relief can be sought. Reading the Treaty in question as a whole when it is intended that even though it is possible for a resident in India to be taxed in terms of Sections 4 and 5, if he is deemed to be a resident of a contracting State whether his personal and economic relations are closer, then his residence in India will become irrelevant. The Treaty will have to be interpreted as such and prevails over Sections 4 and 5 of the Act. Therefore, we are of the view that the High Court is justified in reaching its conclusion, though for different reasons from those stated by the High Court.

The contention put forth by the learned Attorney General that capital gains is not income and, therefore, is not covered by the Treaty cannot be accepted at all because for purposes of the Act capital gains is always treated as income arising out of immovable property though subject to different kind of treatment. Therefore, the contention advanced by the learned Attorney General that it is not a part of the Treaty cannot be accepted because in the terms of Treaty wherever any expression is not defined the expression defined in the Income Tax Act would be attracted. The definition of 'income' would, therefore, include capital gains. Thus, capital gains derived from immovable property is income and therefore Article 6 would be attracted.

The question as to whether by reason of the sale of the property not having been used whether such income is covered by the Treaty, in the Treaty it is specifically provided in sub-clause (2) of Article II that the agreement shall also apply to any other taxes of a substantially similar character to those referred to in the preceding paragraphs imposed in either contracting State after the date of signature of this agreement. And Income-tax is specifically set out in sub-clause (b) of clause (1) of Article II. Tax is levied on capital gains and certainly when capital gains is treated as one kind of income tax it also becomes income and assumes substantially similar character of tax referred to in the preceding paragraph.

Taxation policy is within the power of the Government and Section 90 of the

Income Tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income Tax Act, it would be unnecessary to refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements.

In this view of the matter, it is unnecessary to refer to the decisions cited before us since we have taken the view with reference to clauses set out under the Agreement. We, therefore, find no merit in these appeals and they stand dismissed.

JUDIS