M/S J.B. BODA AND CO. PVT. LTD. A

v.

CENTRAL BOARD OF DIRECT TAXES, NEW DELHI

OCTOBER 30, 1996

[B.P. JEEVAN REDDY AND K.S. PARIPOORNAN, JJ.] B

Income Tax Act, 1961: Section 80-0.

Income Tax—Deduction in respect of royalties etc. from foreign enterprises—Ays 1982-83 to 1984-85—Indian reinsurance—Broker Company arranged for reinsurance by foreign companies of a portion of risk covered by Indian insurance company—The said company received as brokerage a percentage of premium received by foreign companies—After receiving premium in rupees, the said Indian broker, under agreement with foreign company remitted amount of net premium to foreign company after deducting its brokerage—However, Central Board of Direct Taxes (CBDT) refused to approve such agreement for purpose of S.80-0 of IT Act—Held: brokerage retained by Indian broker amounted to receipt of income in convertible foreign exchange—To insist that entire amount be first remitted and then to receive commission in foreign currency would be empty formality—Hence, CBDT's order refusing to approve agreement for purpose of S.80-0 of IT Act improper and illegal—Further, CBDT circular No. 731 dated 20-12-95 was binding on CBDT. C D E

The appellant was a private company engaged in brokerage business as reinsurance brokers. In respect of insurance risk covered by Indian or foreign insurance companies, appellant arranged for the reinsurance of a portion of risk with various reinsurance companies either directly or through foreign brokers. In return for the above services, the appellant—company received a percentage of the premium received by the foreign companies as its share of brokerage. In the instance case Oil and Natural Gas Commission insured all their off shore oil and gas exploration and production operation with the United India Insurance Company. In respect of this insurance risk, the appellant contacted M/s. Sedgwick Offshore Resources Ltd., London who were brokers in London for placement of reinsurance business. The appellant entered into an agreement with the said foreign company for supply of know-how and, while remitting the reinsurance premium, the appellant retained its fee in dollars for technical services F G H

A rendered. The appellant stated in the Assessment Years 1982-83 to 1984-85 that the reinsurance brokerage way retained in India under the agreement with the said foreign company and so it would amount to receipt of income in terms of foreign exchange as per Section 80-0 of the Income Tax Act, 1961 and sought approval of the respondent—Central Board of Direct Taxes (CBDT). The CBDT, however, refused B to approve the agreement for the reason "that income under the agreement is generated in India and is not received in convertible foreign exchange as required under the provisions of Section 80-0". The High Court upheld the order of the CBDT. Being aggreived the appellant preferred the present appeal.

C On behalf of the appellant it was contended that the transaction contemplated by Section 80-0 of the Act need not necessarily be achieved by the form of external remittance followed by internal remittance; and that the CBDT circular No. 731 dated 20-12-1995 clarified the real scope and impact of Section 80-0 of the Act and was binding on the respondent.

D

Allowing the appeal, this Court

HELD : 1.1. Circular No. 731 dated 20-12-1995 promulgated by the Central Board of Direct Taxes (CBDT) is relevant and affords E guidance in understanding the purport of Section 80-0 of the Income Tax Act, 1961. The said circular which seeks to declare and clarify the real scope and impact of Section 80-0 of the Act, is certainly binding on the respondent which issued it. [156-B, 157-E]

1.2. The entire transaction effected through the media of the F Reserve Bank of India is expressed in foreign exchange and in effect the retention of the fee due to the appellant is in dollars for the services rendered. This is receipt of income in convertible foreign exchange. To insist on a formal remittance to the foreign reinsurers first and thereafter to receive the commission from the foreign G reinsurer, will be an empty formality and a meaningless ritual, on the facts of this case. On a perusal of the nature of the transaction and in particular the statement of remittance filed in the Reserve Bank of India regarding the transaction, it is not possible to uphold the view of the respondent-CBDT that the income under the agreement is generated in India or that the amount is one not received in H convertible foreign exchange. [157-GH, 158-A]

Petron Engineering Construction P. Ltd. and Anr. **v.** *Central Board of Direct Taxes and others,* **175 I.T.R. 523, held inapplicable.** A

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 933 of 1989.

From the Judgment and Order dated 29.10.87 of the Delhi High Court in C.W.P. No. 3086 of 1987. B

Dr. V. Shani and S. Rajappa for the Appellant.

J. Ramamurthy, S.N. Terdol and R. Satish for the Respondent. C

The Judgment of the Court was delivered by

PARIPOORNAN, J. 1. The petitioner in Writ Petition No. 3086 of 1987 in the High Court of Delhi, has filed this appeal against the judgment of the High Court dated 29.10.1987. The short matter that arises for D consideration in this appeal is the interpretation to be placed on Section 80-0 of the Income—Tax Act, 1961. Appellant is a private Company. It is engaged in the brokerage business as reinsurance-brokers. It receives a commission @ 3 to 6 per cent, relating to maritime and other insurance. The Respondent is the Central Board of Direct Taxes, Government of India, New Delhi. In respect of insurance risk covered by Indian or foreign E insurance companies, appellant arranges for the reinsurance of a portion of risk with various reinsurance companies either directly or through foreign brokers. In return for the above services, the appellant company receives a percentage of the premium received by the foreign companies as its share of brokerage. For a period of 19 months from 1.3.1980, oil and Natural Gas Commission insured all their offshore oil and gas F exploration and production operation with the United India Insurance Company, Madras. In respect of this insurance risk, the appellant contacted Messrs Sedgwick Offshore Resources Ltd., London who are brokers in London for placement of reinsurance business. The appellant furnished all the details about the risk involved, the premium payable, the period of G coverage and the portion of risk which is sought to be reinsured. The said London brokers contacted various underwriters and after getting confirmation about the portion of the risk the foreign reinsurers were prepared to undertake, informed the appellant about such reinsurance coverage. Thereafter, the Indian Ceding Company handed over the total premium to be paid by it to the foreign reinsurance company to the appellant H

A for onward transmission. When this amount was given to the appellant, the appellant approached the Reserve Bank of India with a statement showing the amount of foreign currency payable as reinsurance premium to the foreign parties after deducting the amount of brokerage due to the appellant. This balance amount after deducting the brokerage, was remitted to the London brokers with the permission of the Reserve Bank of India. B According to the appellant, the amount of Commission retained by it was a receipt of convertible foreign exchange without a corresponding foreign remittance with the meaning of Section 9 of the Foreign Exchange Regulation Act. It is evident that the appellant company by an agreement with the foreign company, with the approval of the Reserve Bank of India remits premium received to the foreign insurance company on behalf of C the Indian insurance company and while doing so, it deducts in terms of foreign exchange fee payable to it while making remittances themselves. The Indian insurers make payment in rupees to the appellant for the amount of reinsurance premium to be remitted to the foreign company, furnishing all particulars with an advice to the appellant to approach the Reserve Bank of India for necessary permission to remit to US Dollars the D reinsurance premium abroad. Thereafter, the appellant writes to the Reserve Bank of India enclosing the remittance application in Form "A-2" as prescribed by the Exchange Control Manual together with the statement and Auditor's Certificate. These can be seen from Annexure-A. A statement is also attached thereto, which shows that the gross amount of the reinsurance premium to be remitted in US Dollars, under the heading E "Balance of Account" and the amount of brokerage also is mentioned in US Dollars, earned by the appellant on the reinsurance premium to be so remitted under the heading "Brokerage". While in the normal course, the entire premium should be remitted abroad to the foreign parties and then the foreign reinsurers would remit the commission back to the appellant, who supplied the information, under the procedure adopted and approved F by the Reserve Bank of India, the appellant remits the amount after deducting the brokerage, which is also expressed in foreign exchange. Thus, the appellant entered into an agreement with M/s. Sedgwick offshore Resources Limited, London for supply of Know-how and, while remitting the reinsurance premium of US Dollars 1060891.68, the appellant remitted G a fee of US Dollars 989887.20 on 11.1.1984 to the Union Bank of India, thus retaining the fee of 71004.48 Dollars for the technical services rendered. The appellant, stating that in the Assessment Years 1982-83 to 1984-85, the reinsurance brokerage determined in foreign exchange is retained in India under the agreement with M/s. Sedgwick Offshore Resources Ltd., and so it would amount to receipt of income in terms of H foreign exchange as per Section 80-0 of the Income-tax Act, sought approval

of the Respondent, Central Board of Direct Taxes as mentioned in Annexure--B. The remittance statement annexed along with Annexure-A available at pages 25-26 of the paperbook, shows the following details:-

"Remittance Statement for the
Period: 1-12-1983 to 10-1-1984.
"FACULTATIVE SECTION"
(M/S. SEDGWICK OFFSHORE RESOURCES LTD.)

		BALANCE OF ACCOUNT		BROKERAGE	
		DEBIT	CREDIT	DEBIT	CREDIT
Ref.	PARTICULARS	U.S.$	U.S.$	U.S.$	U.S.$
	UNITED INDIA INSURANCE CO. LTD.				
9-1-84	Facultative Reinsurance A/c. Oil and Natural Gas Commission Offshore Activities Package Policy-Period:- 1-8-1982 to 31-1-1984— 6th and final Instalment of Premium due on				

		1-11-83 as				
		per closing				
		Particular				
		No. MH/ONGC/23/82				
		dated 3-1-1974		887,667.60	60,868.63	
	9-1-84	Facultative				
		Reinsurance				
		A/c. Oil and				
		Natural Gas				
		Commission				
		Offshore				
		Activities				
		Package				
		Policy-				
		Terrorist				
		Cover				

Period: 1-12-1983 to 10-1-1984.

"FACULTATIVE SECTION"

(M/S. SEDGWICK OFFSHORE RESOURCES LTD.)

BALANCE OF ACCOUNT BROKERAGE

			DEBIT	CREDIT	DEBIT	CREDIT
	Ref.	PARTICULARS	U.S.$	U.S.$	U.S.$	U.S.$
		UNITED INDIA				
		INSURANCE				
		CO. LTD.				
		Period:-				
		1-8-1982 to				
		31-1-1984-				
		6th and final				

	Instalment of Premium due on 1-11-83 as per Closing Particular No.MH/ONGC/22/82 dated 3-1-1984	24,474.08	760.85	A B
9-1-84	Facultative Reinsurance A/c. Oil and Natural Gas Commission Offshore Activities Package Policy—1st and 2nd Layers— 6th and final Instalment of Premium due on 1-11-83 as per Closing Particular No.MH/ONGC/21/82 dated 3-1-1984.	148,750.00	9,375.00	C D E
		1,060,891.68	71,004.48	F
	Balance.... 1,060,891.68		71,004.48	
		1,060,891.68 1,060,891.68	71,004.48 71,004.48	
Balance due to you		U.S.S. 1,060,891.68		G
Less:- Brokerage due by you U.S.S.		71,004.48		
Net Balance due to you		U.S.S. 989,887.20		

(Emphasis supplied)

By communication dated 11.3.1986, the respondent regretted their H

A inability to approve the agreement submitted by the appellant for the purposes of Section 80-0 of the Income-Tax Act for the reason "that income under the agreement is generated in India and is not received in convertible foreign exchange as required under the provisions of section 80-0." The communications in that regard are evidenced by Annexure-C series dated 11.3.1986. It is further seen that the steps taken by the appellant to review
B the Annexure-C proceedings were futile vide Annexure-D. It is thereafter, the appellant moved the High Court of Delhi in Civil Writ No. 3086 of 1987. A Bench of the High Court of Delhi by order dated 29.10.1987, dismissed the said writ petition, stating thus:

> ".....The case of the petitioners is that they had to remit about
C one million dollars in consideration of certain services which they had conducted on behalf of the foreign company and by way of their fees, *they retained the foreign exchange worth six lakhs* and, therefore, they submit that it falls within the expression "such income received in convertible foreign exchange in India". We are afraid, we do not agree with the
D submission of the learned Counsel for the petitioner. To attract this section, the assessee *must receive convertible foreign exchange from abroad. By retaining their fees they are not receiving any* foreign exchange in India but only retaining the convertible foreign exchange. We find no merit in the petition and the same is accordingly dismissed."

E

(Emphasis supplied)

It is thereafter, the appellant has filed the above appeal from the judgment of the Delhi High Court.

F

2. The short question that arises for our consideration is the interpretation to be placed on Section 80-0 of the Income—tax Act.

> "80-0. Deduction in respect of royalties, etc., from certain
G foreign enterprises.
>
> Where the gross total income of an assessee, being an Indian company, *includes any income* by way of royalty, *commission,* fees or any similar payment received by the assessee from the Government of a foreign state *or a foreign enterprise* in
H consideration for the use outside India of any patent, invention,

model, design, secret formula or process, or similar property right, or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided or agree to be made available or provided to such Government *or enterprise by the assessee, or in consideration of technical services rendered* or agreed to be rendered outside India to such Government or enterprise by the assessee, *under an agreement approved in this behalf by the Chief Commissioner or the Director General;* and *such income is received in convertible foreign exchange in India,* or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, is brought into India, by or on behalf of the assessee in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange, *there shall be allowed,* in accordance with an subject to the provisions of this section, *a deduction of an amount equal to fifty percent of the income so received in, or brought into, India,* in computing the total income of the assess:

Provided that the application for the approval of the agreement referred to in this section is made to the Chief Commissioner or, as the case may be, the Director General in the prescribed form and verified in the prescribed manner before the 1st. day of October of the assessment year in relation to which the approval is first sought:

xxx xxx xxx

Explanation— For the purposes of this section—

(i) "convertible foreign *exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange* for the purposes of the law for the time being in force for regulating payments and dealings in foreign exchange:

(ii) "foreign enterprise" means a person who is a non-resident

(Emphasis supplied)

3. It is common ground that remittance to the foreign insurance company on behalf of the Indian insurance company, as also the receipt of the amount of brokerage by the Indian company, should be done only

A with the concurrence of the Reserve Bank of India. The remittance application along with the relevant details and the statement (Annexxure-A), shows the amount due to the foreign company in US dollars as also the brokerage due to the appellant in US dollars and adjustment is made accordingly. The appellant instead of remitting the entire amount to the foreign reinsurers and then receiving remittance from the said reinsurers B the commission due to it, entered into an agreement with the foreign reinsurers, that while remitting the reinsurance premia, the appellant would retain the fee due to it for the technical services rendered and this arrangement is effected only with the concurrence or the permission of the Reserve Bank of India. The question in the instance case is, whether instead of remitting the amount to the foreign reinsurers first and receiving C the commission due to the appellant later, the arrangement by which the appellant remitted the reinsurance premia, after retaining the fee due to it for technical services rendered, will satisfy the requirement of Section 80-0 of the Income—tax Act?

4. Provisions similar to Section 80-0 of the Act were originally D available in the former Section 85 of the Income—tax Act, 1961. While moving the bill relevant to the Finance Act No. 2 of 1967, the then Finance Minister highlighted the fact that fiscal encouragement need to be given to Indian industries to encourage them to provide technical know-how and technical services to newly developing countries. It is also seen that the objective was to encourage Indian companies to develop technical know-E how and to make it available to foreign companies so as to augment the foreign exchange earnings of this country and establish a reputation of Indian technical know-how for foreign countries. The objective was to secure that the deduction under the Section shall be allowed with reference to the income which is received in convertible foreign exchange in India or having been received in convertible foreign exchange outside India, is F brought to India by and on behalf of taxpayers in accordance with the Foreign Exchange Regulations. So also, any income used by the taxpayers outside India in the manner permitted by the Reserve Bank of India, shall be deemed to have been brought into India in accordance with the Foreign Exchange Regulations on the date on which such permission was given. G This is evident from the Circular of Central Board of Direct Taxes, New Delhi (Circular No. 138 dated 17.6.1974) which is available at pages 9 to 11 of the Paperbook.

5. Dr. Gaurishanker, Senior Counsel for the appellant (assessee) vehementaly contented that the provisions of Section 80-0 of the Income H -tax Act will apply to the cases like the present one where the commission

earned is for the supply of such information as is received by a foreign enterprise, which instead of getting the gross commission first and then remitting it back to persons like the appellant its brokerage, permits the appellant to retain amount due and remit only the net amount. It was argued that the financial and the accounting effect is the same and the mere fact that the amount is retained in India with the approval of the foreign reinsurers and the Reserve Bank of India would not take away the basic feature, that the source of income of the appellant was the agreement with the foreign reinsurers and it is in fact received from the foreign reinsurers for services rendered. In other words, it is contended that the transaction contemplated by Section 80-0 of the Income--tax Act need not necessarily be achieved by the form of external remittance followed by internal remittance and the legal nature and the effect of the transaction will remain the same when the amount is credited straightway by making adjustments instead of adopting a two-way traffic. Appellant's counsel also brought to our notice the latest circular of the Central Board of Direct Taxes, New Delhi (Circular No. 731 dated 20-12-1995) which has in turn accepted that the receipt of brokerage by a reinsurance company in India from the gross premia before remittance to its foreign principals will also be entitled for deduction under Section 80-0 of the Act. On the other hand, Senior Counsel for the Revenue, Sri J. Ramamurthy, laid stress on the literal language of Section 80-0 of the Act and contended that in order to qualify for the deduction, the amount by way of royalty, commission, etc. *should be received by the assessee* under an agreement approved in this behalf and such income should *be received in convertible foreign exchange in India.* Counsel contended that the Central Board of Direct Taxes was justified in declining to approve the agreement submitted by the appellant since the income under the agreement is *generated in India and is not received* in convertible foreign exchange as required under section 80-0 of the Act.

6. Counsel for the Revenue brought to our notice the decision in *Petron Engineering Construction P. Ltd. and Another* v. *Central Board of Direct Taxes and Others,* 175 I.T.R. 523, and contended that the income must be directly received by the assessee—the Indian company, and if it is not so directly received, any other substitute arrangement which may have the effect of receipt by the assessee is of no avail. In the said case, the question that arose for consideration was, whether an Indian company doing business or having a branch or establishment in a foreign country can be called a "foreign enterprise", and the question was answered in the negative. It was held that the words "foreign enterprise" occurring in

A Section 80-0 of the Act do not include foreign branch of Indian company. In the said case, the impact of the words "received by an assessee from the Government of a foreign state or foreign enterprise" occurring in Section 80-0 did not arise for consideration nor was considered. The facts of the said case are distinguishable.

B 7. Circular No.731 dated 20.12.1995 promulgated by the respondent filed as Annexure-B (page 8 of the supplementary paperbook) is relevant and affords guidance in understanding the purport of Section 80-0 the Act.:

C "Section 80-0 of the Income-tax Act, 1961—Deduction—Royalties, Etc., from certain foreign enterprises—In case of receipt of brokerage by reinsurance agent, operating in India on behalf of principals abroad, from gross premia before remittance to his foreign principals.

D CIRCULAR NO. 731 DATED 20-12-1995

1. Under the provisions of section 80-0 of the Income-tax Act, 1961 an Indian company or a non-corporate assessee, who is resident in India, is entitled to a deduction of fifty percent of the income received by way of royalty, commission, fees, etc.,
E from a foreign Government or foreign enterprise for the use outside India of any patent, invention, model, design, secret formula or process, etc., or in consideration of technical or professional services rendered by the resident. The deduction is available if such income is received in India in convertible foreign exchange, or having been converted into convertible
F foreign exchange outside India, is brought in by or on behalf of the Indian company or aforementioned assessee in accordance with the relevant provisions of Foreign Exchange Regulation Act, 1973 for the time being in force.

G 2. Reinsurance brokers, operating in India on behalf of principals aborad are required to collect the reinsurance premia from ceding insurance companies in India and remit the same to their principals. In such cases, brokerage can be paid either by allowing the brokers to deduct their brokerage out of the gross premia collected from Indian insurance companies and remit the *net*
H *premia overseas* or they could simply remit the *gross premia*

and get back their brokerage in the form of remittance through banking channels. A

3. The Reserve Bank of India have expressed the view that since the principle underlying both the transactions is the same, there is no difference between the two modes of brokerage payment. In fact, the *former method is administratively* more convenient B and the reinsurance brokers had been following this method till 1987 when they switched over to the second method to avail of deduction under section 80-0 of the Act.

4. The matter has been examined. The condition for deduction under section 80-0 is that the receipt should be in convertible C foreign exchange. When the commission is remitted aborad, it should be in a currency that is regarded as convertible foreign exchange according to FERA. Board are of the view that in such cases the *receipt of brokerage by a reinsurance agent in India from the gross premia before remittance to* his foreign principals will also be entitled to *the deduction under section 80-0* of the Act. D

(Emphasis supplied)

The said circular which seeks to declare and clarify the real scope E and impact of Section 80-0 of the Act, is certainly binding on the respondent which issued it.

8. The facts brought out in this case, are clear as to how the remittance to the foreign reinsurance company is made through the Reserve Bank of India in conformity with the agreement between the appellant and the F foreign reinsurers, and that the remittance statement filed along with Annexure-A which evidences that the amount due to the foreign reinsurers as also the brokerage due to the appellant and the balance due to the foreign reinsurers is remitted (and expressed so) in dollars. It is common ground that the entire transaction effected through the media of the Reserve Bank G of India is expressed in foreign exchange and in effect and retention of the fee due to the appellant is in dollars for the services rendered. This, according to us, is receipt of income in convertible foreign exchange. It seems to us that a "two way traffic" is unnecessary. To insist on a formal remittance to the foreign reinsurers first and thereafter to receive the commission from the foreign reinsurer, will be an empty formality and a H

A meaningless ritual, on the facts of this case. On a perusal of the nature of transaction and in particular the statement of remittance filed in the Reserve Bank of India regarding the transaction, we are unable to uphold the view of the respondent that the income under the agreement is generated in India or that the amount is one not received in convertible foreign exchange. We are of the view that the income is received in India in convertible
B foreign exchange, in a lawful and permissible manner through the premier institution concerned with the subject-matter—the Reserve Bank of India. In this view, we hold that the proceedings of the Central Board of Direct Taxes dated 11-3-1986, declining to approve the agreements of the appellant with *M/s. Sedgwick Offshore Resources Ltd., London* for the purposes of section 80-0 of the Income-tax Act, are improper and illegal. We declare
C so. We direct the respondent to process the agreements in the light of the principles laid down by us hereinabove. The appeal is allowed. There shall be no order as to costs.

V.S.S. Appeal allowed.