Form No. J(2)

IN THE HIGH COURT AT CALCUTTA

SPECIAL JURISDICTION (Income Tax)
(Original Side)

Coram: THE HON'BLE JUSTICE RAJARSHI BHARADWAJ,
And
THE HON'BLE JUSTICE UDAY KUMAR

Reserved on : 31.07.2026.

Pronounced on : 22.09.2026

ITA 699 of 2007
With
GA 1 of 2014 (Old No.3327 of 2014)

The Royal Bank of Scotland, N.V.
...Appellant

-VS-

Director of Income Tax (International Taxation), Kolkata

....Respondent

Present:-

Mr. Percy J. Pardiwalla, Adv.
Mr. Akhilesh Kumar Gupta, Adv.
Mr. Asit Kumar De, Adv.

...for the appellant

Mr. Prithu Dudhoria, Adv.
Mr. Amit Sharma, Adv.

..... for the Respondent

Rajarshi Bharadwaj, J:

1. The appellant has filed this appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), challenging the order dated July10, 2007 passed by the Learned Income Tax Appellate Tribunal (ITAT), Kolkata Bench "C", for the assessment year AY 2003-04, on the substantial questions of law formulated at the time of admission.

2. The facts of the case in a nutshell are that the appellant, Royal Bank of Scotland N.V. (formerly known as ABN Amro Bank N.V.), is a non-resident foreign company incorporated in the Netherlands. The parties are before this Court regarding disputes arising from the Assessment Year 2003-04. The appellant carries on banking operations in India through a branch, which is recognised as a Permanent Establishment (PE) under the Income Tax Act, 1961 and the Double Taxation Avoidance Agreement (DTAA) between India and the Netherlands.

3. For the assessment year in question, the appellant filed its Return of Income and asserted that it should be taxed at the rate applicable to domestic companies rather than the higher rate for foreign companies. This claim was based on the non-discrimination clause in Article 24(2) of the DTAA. Additionally, the appellant claimed a deduction for interest payments made by the Indian PE to its overseas head office and other branches. The appellant's position on these two issues, i.e., the tax rate and interest deductibility was consistent with the positions taken in its appeals for earlier years, specifically the 1999-2000 assessment year.

4. A significant factual development for the 2003-04 assessment year is that the appellant disputed the depreciation rate applicable to its Automated Teller Machines (ATMs). The appellant claimed depreciation on these machines at the higher rate reserved for "computers" under the Income Tax Rules. However, the Tribunal restricted this claim, leading to the current challenge regarding whether an ATM qualifies as a computer for tax purposes.

5. The procedural history shows that the CIT(Appeals) and the Tribunal largely upheld the AO's findings regarding the higher tax rate and the disallowance of interest payments for lack of TDS. Regarding the lease rentals, while the CIT(A) and Tribunal confirmed the treatment of the principal component as capital expenditure, the CIT(A) did direct the AO to grant consequential depreciation to the appellant. This Court subsequently admitted this appeal to determine six substantial questions of law covering the tax rate, interest deductions, lease rental classifications and ATM depreciation.

6. Learned senior counsel appearing for the appellant raises the issue on the following substantial questions of law that have been admitted:

i. *Whether on a true and proper interpretation of the provisions of sections 2(22A) and 90 of the Income Tax Act, 1961 read with CBDT Circular No. 333 dated April 2, 1982 and CBDT's letter dated November 21, 1994 and Article 24(2) of the Double Taxation Avoidance Agreement between India and Netherlands, the Tribunal was justified in law in holding that the Appellant was liable to income tax at the higher rate applicable to a foreign company and not at the rate of tax applicable to a domestic company?*

ii. *Whether on a true and proper interpretation of the provisions of the Income Tax Act, 1961 and the Double Taxation Avoidance Agreement between India and the Netherlands, the Tribunal was justified in law in holding that the interest payment made to the head office and other branches abroad was not to be allowed as a deduction in computing the profits of the permanent establishment of the Appellant in India?*

iii. *Whether and in any event, if the interest paid by the permanent establishment to the head office/other branches abroad is not an allowable deduction in the computation of the profits of the permanent establishment on the ground that it represents interest paid to self, the interest received by the permanent establishment from the head office/other branches abroad is also not to be included in computing the profits of the permanent establishment and the Tribunal was justified in law in not directing exclusion of such interest received?*

iv. *Whether the Tribunal erred in law in not treating ATM as "computer" falling under item 2B of Appendix I to the Rules and restricting the claim for depreciation?*

7. We have heard the appellant and learned Counsel for the respondent revenue at length. Since the issues involved are pure questions of law, this Court proceed to decide the appeal on merits.

8. This Court has carefully considered the rival submissions regarding whether the appellant, a non-resident banking company incorporated in the Netherlands, is entitled to be taxed at the lower rate applicable to domestic companies by virtue of the non-discrimination clause in Article 24(2) of the India-Netherlands Double Taxation Avoidance Agreement (DTAA). The appellant's primary contention rests on the premise that its Indian Permanent Establishment (PE) should not be subjected to a tax treatment less favourable than that of an Indian enterprise carrying on similar activities. However, the statutory framework of the Income Tax Act, 1961, particularly after the retrospective amendment to Section 90, dictates a different conclusion.

9. The definition of a "domestic company" under Section 2(22A) is clear and requires a company to either be an Indian company or to have made prescribed arrangements for the declaration and payment of dividends within India. The appellant has admittedly not fulfilled these criteria and thus falls squarely within the definition of a "foreign company" under Section 2(23A). This Court finds that the classification between domestic and foreign companies for the purpose of tax rates is a valid and reasonable classification.

10. The central issue is the impact of the explanation to Section 90, inserted by the Finance Act, 2001, with retrospective effect from April 1, 1962. The explanation explicitly declares that charging a higher rate of tax on a foreign company shall not be regarded as "less favourable" treatment. As held by the Division Bench of this Court in ***Royal Bank of Scotland N.V. v. Commissioner of Income Tax*** reported in ***(2026) 494 ITR 171***, the explanation is clarificatory and must be given full effect as part of the statute. The judgment emphasised that even without the explanation, the statutory provisions of the Finance Act and the Income Tax Act remain clear that a non-domestic company is liable to the rate specified for such an entity.

11. Furthermore, the "same circumstances" requirement in Article 24(2) of the DTAA is not met. A foreign company and a domestic company are not in identical circumstances because the former is taxed only on Indian-sourced income, whereas the latter is taxed on its global income. Consequently, the differential tax rate does not constitute prohibited discrimination under the treaty. Regarding CBDT Circular No. 333, this Court observes that it only prioritises treaty provisions where a specific contrary provision exists. However, the India-Netherlands DTAA contains no specific provision prescribing a tax rate that overrides the domestic Finance Act. Therefore, this Court must adhere to the settled law that the retrospective legislative amendment clarifies the original intent, leaving no room for the appellant to claim the domestic rate. We answer substantial question (1) in the affirmative, i.e., against the assessee and in favor of the revenue.

12. The dispute regarding the deductibility of Rs.99,77,325/- paid as interest by the Indian branch to its overseas head office hinges on the mandatory compliance with Tax Deducted at Source (TDS) provisions. The revenue's position is anchored in Section 40(a)(i) of the Act, which stipulates that any interest payable outside India shall not be deducted in computing profits if tax has not been paid or deducted at source. The appellant's primary defense that the payment is a payment to self because the branch and head office are the same legal entity, fails to account for the specialised "separate entity" fiction required for international tax purposes.

13. For the purpose of determining the profits of a Permanent Establishment (PE) under Article 7 of the DTAA, the branch is treated as if it were a separate and distinct enterprise. The appellant seeks to take advantage of this fiction to claim an interest deduction as a business expense but attempts to discard the same fiction to avoid the obligation to deduct tax at source. This Court finds this approach legally untenable. As clarified by CBDT Circular No. 740, the branch of a foreign bank is treated as a separate entity for taxation and interest remitted to its head office is liable to tax in India. Consequently, such payments attract the TDS requirements of Section 195.

14. If the appellant's contention were accepted that the PE and Head Office are one person then the interest payment would not qualify as a business expense at all, as one cannot legally pay interest to oneself in a way that generates a tax deduction. However, since Article 7(3) of the DTAA allows for the deduction of such expenses in the case of banking enterprises, it necessarily implies that the recipient (the head office) is receiving income that has its source in India. The procedural safeguard of TDS is the mechanism by which the Indian state ensures the collection of tax on this income.

15. The failure to deduct tax before making these remittances directly triggers the disallowance under Section 40(a)(i). The limitation on allowability of interest is subject to the domestic laws of the State where the PE is situated and the appellant must comply with the procedural mandates of the Income Tax Act to avail of the treaty benefit. Allowing a deduction for an interest expense while exempting the same amount from TDS would create an asymmetrical tax advantage not intended by the DTAA or the Act. Therefore, the Tribunal was justified in upholding the disallowance of the interest payment due to non-compliance with the statutory TDS requirements. We answer substantial question (2) in the affirmative, i.e., against the assessee and in favor of the revenue.

16. The issue under substantial question (3) concerns whether interest received by the Indian Permanent Establishment (PE) from its overseas head office and other foreign branches must be excluded from the computation of its Indian profits. The appellant argues that if interest payments to the head office are treated as non-deductible "payments to self," the corresponding interest received from those same entities should, by the same logic, be excluded from taxable income. This Court, however, finds the appellant's argument unsustainable.

17. First, substantial questions (2) and (3) are distinct and independent issues. The disallowance of interest expenditure under question (2) was not because the PE and the head office are treated as a single entity to deny the deduction, rather, it was triggered by the appellant's failure to comply with the mandatory tax deduction at source (TDS) requirements under Section 40(a)(i) of the Act. This procedural statutory disallowance does not alter the underlying character of the interest transactions.

18. Second, under Article 7 of the India-Netherlands DTAA, a legal fiction treats the PE and the overseas head office as separate and distinct enterprises for the purpose of determining profits. Under this "separate entity" framework, the branch and the head office are recognised as independent establishments. Just as interest paid by the PE to the head office is an allowable deduction in the hands of the PE (subject to statutory compliance like TDS), similarly, interest received by the PE from the head office or other foreign branches represents taxable business income earned by the Indian PE.

19. Because the PE operates as a separate establishment for tax purposes under the DTAA, the interest received cannot be characterised as an excludable "payment to self" or shielded under the principle of mutuality. To hold otherwise would disrupt the consistent application of the separate entity fiction required for international taxation.

20. Consequently, the interest income received by the PE from its foreign head office and other branches must be included in computing its taxable profits in India. The Tribunal was fully justified in law in not directing the exclusion of such interest received. We answer the substantial question (3) in the affirmative, i.e., against the assessee and in favour of the revenue.

21. The final question pertains to the appropriate rate of depreciation for the Automated Teller Machines (ATM) and whether they should be classified as "computers" under the Income Tax Rules. The appellant contends that the Tribunal erred by not treating ATMs as computers, which would have qualified them for a higher rate of depreciation under item 2B of Appendix I to the Rules.

The classification of hardware in the modern banking sector requires an understanding of the functional and technical characteristics of the equipment in question. An ATM is not merely a mechanical cash dispenser, it is a complex data-processing unit that relies on internal processing power, specialised software and constant network communication with central banking servers to perform its primary functions.

22. The appellant's submissions on this point are consistent with those raised in earlier assessment years, specifically the appeals for the 2002-03 period. The argument rests on the fact that the core of an ATM's operation is digital data processing which is the defining characteristic of a computer as envisioned by the tax rules. By restricting the depreciation rate, the authorities have adopted an overly narrow interpretation of the term "computer" that fails to account for the technological integration inherent in modern banking infrastructure. In the digital age, devices that perform automated processing and data transmission should be afforded the same tax treatment as other computing hardware, provided their primary function is the electronic management of information.

23. The classification of an asset for depreciation purposes must be determined by its functional utility in the business of the assessee. For a banking enterprise, ATMs serve as the primary interface for digital transactions, performing many of the same tasks as a standard workstation or server. The revenue's attempt to categorise these units as general office equipment or machinery ignores the technical reality that they are specialised computing devices. Given that the technical specifications of an ATM align with the broad category of computers described in Appendix I, the appellant's claim for the higher depreciation rate is sustainable. This court finds that the functional parity between an ATM and a computer is sufficient to warrant its inclusion under the relevant rule for depreciation. We answer the substantial question (4) in the negative, i.e., against the revenue and in favor of the assessee.

24. For the foregoing reasons, the appeal under Section 260A is allowed in part, with substantial questions of law (1), (2) and (3) answered in the affirmative and in favour of the revenue, while substantial question (4) is answered in the negative and in favour of the appellant-assessee. The impugned order of the Learned Tribunal dated July 10, 2007, is hereby modified to this extent and the Assessing Officer is directed to pass a consequential order giving effect to the reliefs granted herein for the Assessment Year 2003-04.

25. All connected applications are disposed of accordingly. There shall be no order as to costs.

26. Urgent certified copy, if applied for, be supplied upon compliance with requisite formalities.

(RAJARSHI BHARADWAJ, J)

(UDAY KUMAR , J)

Kolkata
22.09.2026
PA(BS)