**IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA 493/2008,ITA 743/2006**
**ITA 494/2008,ITA 495/2008**
**ITA 496/2008,ITA 497/2008**
**ITA 498/2008,ITA 498/2008**
**ITA 584/2008,ITA 647/2008**
**ITA 648/2008,ITA 649/2008**
**ITA 650/2008,ITA 663/2008**

% Judgment Reserved On: 19.7.2011
Judgment Delivered On: 30.8.2011

**(1) ITA 493/2008**
**ROLLS ROYCE PLC** **. . . APPELLANT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .RESPONDENT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(2) ITA 743/2006**
**ROLLS ROYCE PLC** **. . . APPELLANT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .RESPONDENT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

**(3) ITA 494/2008**
**ROLLS ROYCE PLC** **. . . APPELLANT**

Through: Mr. S. Ganesh, Sr. Advocate with Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** ...RESPONDENT

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(4) ITA 495/2008**
**ROLLS ROYCE PLC** ...APPELLANT

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** ...RESPONDENT

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(5) ITA 496/2008**
**ROLLS ROYCE PLC** ...APPELLANT

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** ...RESPONDENT

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(6) ITA 497/2008**
**ROLLS ROYCE PLC** ...APPELLANT

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .RESPONDENT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(7) ITA 498/2008**

**ROLLS ROYCE PLC** **. . . APPELLANT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .RESPONDENT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

**(8) ITA 584/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

**(9) ITA 647/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates

**(10) ITA 648/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. ..APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates

**(11) ITA 649/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. ..APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates

**(12) ITA 650/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. ..APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Stan Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates

**(13) ITA 663/2008**

**DIRECTOR OF INCOME TAX, INTERNATIONAL TAXATION** **. . .APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

VERSUS

**ROLLS ROYCE PLC** **. . . RESPONDENT**

Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates

**CORAM :-**

**HON'BLE MR. JUSTICE A.K. SIKRI**
**HON'BLE MR. JUSTICE M.L. MEHTA**

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

Yes

**A.K. SIKRI, J.**

1. These appeals of the assessee were admitted on the following questions of law vide orders dated 25th September, 2008:-

> "1. Whether the Income Tax Appellate Tribunal was correct in holding that the reassessment proceedings under Section 147/148 of the Income-Tax Act 1961 were valid?
>
> 2. Whether the office of Rolls Royce India Limited at New Delhi constituted a permanent establishment of the assessee under Article 5 of the Double Taxation Avoidance Agreement between India and the United Kingdom?
>
> 3. If the answers to questions No.1 & 2 are against the assessee, then what would be the appropriate amount of profits attributable to the permanent establishment of the assessee in India?
>
> 4. Whether the findings of the Income Tax appellate Tribunal with regard to the existence of the permanent establishment of the assessee in India are perverse?"

2. On an application preferred by the appellant/ assessee, following additional question of law was framed as substantial question of law, to be addressed at the time of hearing:-

> "Whether a coordinate bench of the tribunal while passing an order can take a contrary view that has been expressed by an earlier coordinate bench in respect of the same assessee where similar issues are involved or should the bench refer it to a larger bench"?

3. We may point out at the outset that Mr. Ganesh, learned Senior Counsel appearing for the appellant/assessee did not press all these

questions at the time of hearing. The learned counsel for the asse did not argue the validity of reopening of assessment under Section 147 of the Income-Tax Act. Even on additional question framed vide orders dated 7th July, 2010, no arguments were raised. Accordingly, questions no. 1 and additional question framed on 7th July, 2010 are decided against the assessee, as not pressed.

4. Even on the question of permanent establishment on which aspect question of law no. 2 and 4 have been framed, there was no serious contest. As would be noticed later, the only attempt on the part of Mr. Ganesh was to persuade this Court to refer the matter back to the ITAT and decide this issue afresh in the light of the objections filed by the assessee. We may mention that Rolls Royce India Limited (RRIL) is 100% subsidiary set up in India and it is held to be the PE of the assessee. Since this was the submission in the alternative and main focus of attack on the findings of ITAT rested on question of law no.3, we will first deal with that question. Reason is obvious. Mr. Ganesh argued that even if it is so, the payment made by the assessee to RRIL for the services rendered by RRIL on behalf of the assessee constitutes arm's length price (ALP) and, therefore, nothing more was to be taxed at the hands of the assessee.

5. We may capture some material facts needed to answer this question of law no.3.

6. The appellant is a company incorporated under the laws of England and Wales and is a tax resident in the United Kingdom. The appellant is a Non-Resident under the provisions of the Indian Income Tax Act. The appellant supplies certain parts and equipment to Indian customers who are mainly Indian Navy, Indian Air Force and Hindustan Aeronautics Limited (HAL). There is another company namely Ms/ Rolls Royce Indian Limited (RRIL) which is a company incorporated under the Laws of England and Wales and is tax resident in the United Kingdom. RRIL has offices in India which render liaison services. The liaison offices have been established after taking approval from the Reserve Bank of India. RRIL renders liaison services and such services are rendered inter alia by the liaison offices of RRIL in India for which RRIL is remunerated on a cost plus basis.

7. The Assessing Officer after holding that RRIL was PE of the assessee and there were business connection between the two as the marketing and sale of goods to Indian customer were carried out by the assessee

through RRIL substituted in India. He was of the view that pr attributable from PE was liable to tax in India in terms of Article 7 of DTAA. The Assessing Officer accordingly invoked Rule 10 of the Income Tax Rules , 1962 and attributed 100% of profits earning from sale of goods from Indian customer in the assessment year 1997-98 to 2000-01 and 75% of profits in the assessment year 2002-03 and 2003-04.

8. The CIT (A) upheld the order of the Assessing Officer for the Assessment years 1997-98; 1998-99, 1999-00, 2000-01 and held that the offices of the RRIL in India constitute permanent establishment of the appellant in India under Article 5 of the Double Taxation Avoidance Agreement Between India and United Kingdom (hereinafter referred to as "DTAA"). However, the CIT (A) had modified the order of the Assessing Officer to the extent that the profits attributable to the activities carried on India were deemed to be 75% instead of 100% of the estimated profits as held by the assessing Officer. The order of the CIT (A) was carried in appeal before the ITAT and ITAT also upheld the order of the CIT (A). However, it modified the order of the CIT (A) to the extent that the profits attributable to the activities carried on in India were estimated at 35% instead of 75% as held by the CIT (A).

9. Mr. Ganesh has not challenged the order of the ITAT insofar as it attributed 35% of the global profits to the activities carried out in India. His grievance on this aspect was also very limited and confined to the set off of net research and development expenses while computing the income. To put it precisely, the submission was that though the Tribunal had held that 35% of the global profits in respect of sale effected in India were chargeable to tax in India in the impugned order the Tribunal had not satisfied as to which profit is to be adopted for this purpose.

10. After the impugned decision, the assessee had preferred MA 55-60/Del/2008 before the Tribunal raising various issues including the one raised above. It was contended that even if the income is to be computed, only net profit to be taxed should be considered and not the trading profit. The assessee had sought clarification by means of aforesaid application, *inter alia,* on this point as well contending that in the absence of clarity, there may be confusion while giving effect to the order of the Tribunal. The Tribunal disposed of this application vide order dated 30th January, 2009 clarifying that in para 24.1 of the impugned order it had held that out of the total profits on global basis, 50% of the profit is to be attributed to the manufacturing activity, 15% to research and development activities and balance to marketing activities and since

marketing activities are carried out in India to the extent of sales in I and proportionate profit is to be attributed to the global profits.

11. It is also remarked that the Assessing Officer had adopted the global profits being trading profit which represents gross profit less commercial marketing product support cost and general administration cost, but before net of the research and development expenses and exceptional items. The contention of the learned counsel for the assessee that net research and development expenses should also be reduced while computing operating profits was rejected by the Tribunal on the ground that no part of research and development activities is carried out in India. There is a sufficient clarification on this aspect by the Tribunal in the following words:-

> "The contention of the learned counsel for the assessee is that net research and development expenses should also be reduced while computing operating profit. We are unable to accept such contention. It is an admitted fact that no part of the research and development activities are carried out in India. The research and development do contribute to t the profit and in respect of which Tribunal have apportioned 15% thereof and directed to exclude the same while computing global profits. While computing the profit which is to be attributed to the activities in India, only those factors affecting such profit are to be considered. Thus, if some activities are carried out by the assessee wholly outside India in respect

of which no profit can be attributable to the activities in India, then such profit cannot be taxed in India. In the same fashion if some activities are carried outside India resulting into loss to the assessee, such loss is also to be ignored while computing the profit, which is composite, to the proportionate of activities in India. The activities in India are in the form of marketing and sales. Therefore, all the expenses incurred till the marketing are to be reduced. The research and development activities which result into loss to the assessee and admittedly not being carried out in India is to be ignored while computing global profits to be attributed to Indian operations. Therefore, the computation of profit as done by the Assessing Officer is to be upheld subject to our observations in para 24.1 of the order of Tribunal."

12. We are in agreement with the aforesaid view of the Tribunal. While restricting the attribution to 35%, the reason given by the Tribunal was that profit attributed to manufacturing activity and research and development activities i.e. 50% and 15% respectively had to be excluded. Thus the expenses on research and development were already taken care of when remuneration @ 35% was attributed to marketing activities in India on which global profits was apportioned and there was no question of setting off the research and development expenses again in respect of marketing activities . We, thus, answer question no.3 against the assessee.

13. With this, we revert back to the issue of PE on which question of law no. 2 & 4 are framed. As already pointed out, there is no serious contest to the findings arrived at by the Tribunal touching various facets of the business relation between RRIL and the assessee on the basis of which RRIL, which is a 100% subsidiary setup in India is held to be as PE of the assessee. Only a limited challenge was laid to the impugned order was predicated on the objections which the assessee had filed to the Remand Report obtained by the CIT (A) from the Assessing Office. It was argued that the assessee had filed its objections which is duly acknowledged by the ITAT in para 19 of the impugned order. Alongwith objections, the assessee had filed various documents which fact is also acknowledged by the ITAT in the impugned order. The grievance is that the objections as well as those documents were not even considered properly. From these documents the assessee only wanted to show that the RRIL does not constitute its PE in India.

14. When we examine the discussion of the CIT (A) as well ITAT on the aspects of PE, we are convinced that for sufficient and adequate reasons, the authorities below have held that RRIL to be the PE of the assessee in India and in the process, the objections of the assessee are duly met with and answered. Though, there is an elaborate discussion on this aspect,

We may summarise the same by pointing out that the Tribunal deline six questions which had arisen for consideration and those are stated in para-16 of the impugned order. Questions no. 2 and 3 were precisely on this very issue which are as under:

> "(2) Whether the assessee has any income chargeable to tax in India u/s 5 (2) of the Act and whether the assessee has any business connection in India as per Section 9 (1) (i) of the Act?
> (3) If the answer to Question No.2 is in affirmative, whether, in terms of DTAA between India and UK, the appellant has any PE in India?"

15. The Tribunal first considered the question of business connection. After taking note of the relevant provisions which existed at that time as well as the case law, in para-19, the Tribunal took note of the fact that an agreement was entered into by the assessee with RRIL whereby RRIL was to render certain services to the assessee. From the extent and scope of these services, the Tribunal held that the assessee had a business connection in India within the meaning of Section 9(1)(i) of the Act. It would be relevant to point out at this stage that the aforesaid conclusion of the Tribunal was not rested solely on the agreement with RRIL. It also took into consideration and analysed various papers which were found during the course of the survey and which were not there earlier when

the Tribunal had decided the appeal of the assessee for the assessr year 2001-02. It is not necessary to state in detail the nature of those documents having regard to the fact that before us this aspect of business connection was not disputed. However, we would still like to reproduce the following observations of the Tribunal in this behalf:-

> "The material existed for all the time to come and it is unfortunate that the assessee never disclosed its true relationship vis-à-vis RRIL. Only after the survey was conducted, the true face has come out. Once this material was found, the appellate proceedings were pending and were being considered by learned CIT (A) after calling for a remand report from the AO. The objections of assessee against the remand report were also considered. However, since the material relates to the entire business activity even for all the years under appeal, there is no case that the same should be ignored only because the same were not found after the conclusion of assessment proceedings but before the conclusion of appellate proceedings. Prima facie these papers itself show the extent of work being handled by RRIL for appellant in India. RRIL is not only 100% subsidiary of the appellant but also maintains a permanent office in India to undertake all such activities. Thus, it can be concluded that the appellant has a business connection in India within the meaning of Section 9(1) (i) of the Act and under the Income-Tax Act, its income is chargeable to tax in India arising out of such business connections."

15. After holding that the assessee had business connection in Ir the Tribunal adverted to the question as to whether there was any PE in India within the meaning of Article 5 of the Indo-UK DTAA. The Tribunal extracted the provisions of Article 5 and stated the legal position that emerged therefrom. Thereafter, it referred to various documents in para 22 and narrated its effect in detail. Our purpose would be served by extracting para 23 of the impugned order which reads as under:-

> "23. It is also seen that the appellant has a dependent agent in India in the form of RRIL. The fact that RRIL is totally dependent upon the appellant is not denied. However, the contention of the appellant is that even though RRIL is a dependent agent and such agency is to be deemed as PE, so long such dependent agent has no authority to negotiate and enter into contracts, under Article 5 (4), there is no PE in India. It is to be noted that Article 5 (4) has three clauses, namely, a, b & c. Thus, even if one has to hold that the dependent agent has no authority to negotiate and enter into contracts for and on behalf of appellant, still as per clause (c) of sub Article (4), it is found that RRIL habitually secures orders in India for the appellant. It is a set practice that no customers in India are directly to send orders to the appellant in UK. Such orders are required to be routed only through RRIL. This fact is evident from the letter of Mr. L.M. Morgan to Mr. Prateek Dabral and Ms. Usha. In the said letter, it is made clear that even request for quotation/extension could not be communicated directly to the appellant but are to be routed through the office of RRIL. This is applicable even to the orders. The fact is not denied that the orders are firstly received by RRIL from the customers in India and only then communicated to the appellant. Thus, as per Para 4(c) of Article 5, the dependent agent habitually secures orders wholly for the enterprise itself and hence, is deemed to be a permanent establishment of the appellant. The contention of appellant that the role of RRIL is merely

of a post office is, therefore, unacceptable in view of the facts of the case as evidenced by various documents and correspondence found during the course of survey. It can, therefore be summarized that in the light of the facts as well as documents mentioned above, RRIL's presence n India is a permanent establishment of appellant because:

(a) It is a fixed place of business at the disposal of the Rolls Royce Plc and its group companies in India through which their business are carried on.

(b) The activity of this fixed place is not a preparatory or auxiliary, but is a core activity of marketing, negotiating, selling of the product. This is a virtual extension/projection of its customer facing business unit, who has the responsibility to sell the products belonging to the group.

(c) RRIL acts almost like a sales office of RR Plc and its group companies.

(d) RRIL and its employees work wholly and exclusively for the Rolls Royce Plc and the Group.

(e) RRIL and its employees are soliciting and receiving orders wholly and exclusively on behalf of the Rolls Royce Group.

(f) Employees of Rolls Royce Group are also present in various locations in India and they report to the Director of RRIL in India.

(g) The personnel functioning from the premises of RRIL are in fact employees of Rolls Royce Plc. This has been admitted by the MD Mr. Tim Jones, GM, and can be discerned from statement of Mr. Ajit Thosar and documents like terms of employment of GMS.

Thus, the appellant can be said to have a PE in India within the meaning of Article 5 (1), 5(2) and 5(4) of the Indo UK DTAA. Since we have found that the appellant has a business connection in India as well as PE in India, the income arising from its operation in India are chargeable to tax in India."

17. We are thus convinced that there is a detailed discussion taking into consideration all the relevant aspects while holding that RRIL constituted PE of the assessee in India. While undertaking critical analysis of the material on record, the Tribunal kept in mind the objections filed by the assessee as well as the documents on which it wanted to rely upon. Those objections were duly met and answered.

18. We thus, do not find any need to remand the case back to the Tribunal for this purpose which was the plea raised by the learned Counsel for the appellant/assessee. Agreeing with the view taken by the ITAT in the impugned order as well as in the Misc. Application, we answer questions no.2 & 4 against the assessee. As a result, we find no merits in the appeals of the assessee which are accordingly dismissed.

19. In the appeals preferred by the Revenue only the extent of income attributable to the PE is questioned. The case of the Revenue is that it should not have been restricted as done by the CIT (A) and modified by the ITAT. The submission is that the order of the Assessing Officer be maintained.

20. Since we have upheld the order of the ITAT in its entirety inclu on this aspect while discussing the appeals of the assessee, as a consequence, all the appeals of the Revenue on this aspect are also dismissed.

**(A.K. SIKRI)**
**JUDGE**

**(M.L. MEHTA)**
**JUDGE**

**AUGUST 30, 2011**
Skb