REPORTABLE

* IN THE HIGH COURT OF DELHI AT NEW DELHI

\+ ITA 1278/2010,ITA 1280/2010
ITA 1281/2010,ITA 1282/2010
ITA 1284/2010,ITA 249/2011
ITA 250/2011,ITA 251/2011
ITA 252/2011,ITA 253/2011
ITA 254/2011,ITA 255/2011
ITA 256/2011,ITA 257/2011
ITA 258/2011,ITA 259/2011
ITA 260/2011

% *Judgment Reserved On: 19.7.2011*
Judgment Delivered On: 30.8.2011

(1) ITA 1278/2010
ROLLS ROYCE SINGAPORE PVT. LTD. . . . APPELLANT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

ASSISTANT DIRECTOR OF INCOME TAX . ..RESPONDENT
Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

(2) ITA 1280/2010
ROLLS ROYCE SINGAPORE PVT. LTD. . . . APPELLANT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

ASSISTANT DIRECTOR OF INCOME TAX . ..RESPONDENT
Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel

(3) ITA 1281/2010
ROLLS ROYCE SINGAPORE PVT. LTD. . . . APPELLANT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

ASSISTANT DIRECTOR OF INCOME TAX . ..RESPONDENT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

(4) ITA 1282/2010
ROLLS ROYCE SINGAPORE PVT. LTD. . . . APPELLANT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

ASSISTANT DIRECTOR OF INCOME TAX . ..RESPONDENT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

(5) ITA 1284/2010

ROLLS ROYCE SINGAPORE PVT. LTD. . . . APPELLANT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

VERSUS

ASSISTANT DIRECTOR OF INCOME TAX . ..RESPONDENT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

(6)ITA 249/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 250/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 251/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 252/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 253/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 254/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT
Through: Mr. S. Ganesh, Sr. Advocate with Mr. Mukesh Butani, Mr. H. Raghavendra Rao, Mr. Arjit Prasad, Advocates.

(6)ITA 255/2011
ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT
Through: Mr. Sanjeev Sabharwal, Sr.Standing Counsel.

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT

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

(6)ITA 256/2011

ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT

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

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT

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

(6)ITA 257/2011

ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT

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

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT

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

(6)ITA 258/2011

ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT

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

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT

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

(6)ITA 259/2011

ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT

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

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..RESPONDENT

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

(6)ITA 260/2011

ASSISTANT DIRECTOR OF INCOME TAX . . . APPELLANT

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

VERSUS

ROLLS ROYCE SINGAPORE PVT. LTD. . ..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?

A.K. SIKRI, J.

1. These 17 appeals arise out of the common order dated 19th March, 2010 passed by the Income-Tax appellate Tribunal (hereinafter referred to as the ITAT), 5 appeals are filed by the assessee and 12 appeals are

filed by the Revenue. Particulars of the five appeals of the assessee as under:-

SL. NO.	APPEAL NO.	ASSESSMENT YEAR
1	ITA 1278/2010	2003-04
2.	ITA 1280/2010	2000-01
3.	ITA 1282/2010	2004-05
4.	ITA 1284/2010	2001-02
5.	ITA 1281/2010	2002-03

These appeals pertain to the assessment year 2000-01 to 2004-05.

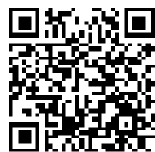
2. Before coming to the respective grievances of the Assessee and the Revenue, we would like to trace the genesis of the dispute and the nature of impugned order passed by the Tribunal as narration thereof would make it easier to understand the grounds on which the impugned orders are challenged by both the parties.

3. The assessee viz Rolls Royce Singapore Ltd. (hereinafter referred to as the 'Singapore Company') is a company incorporated under the laws of Singapore. The principal activities of the Singapore Company are sale of spares parts for oil field equipment and engines and turbine

compressor systems and electronic retrofit projects and services rend in connection with repair and overhauling of such equipment. The Singapore Company is a non-resident for the tax under the provisions of Income-Tax Act, 1961.

4. The Singapore Company rendered repair and maintenance services and supply spares to customer in India in the Oil and Gas industry. The major clients of the Singapore Company in India include public sector undertakings like ONGC, Gail etc. The largest customer of the Singapore Company in India is ONGC. As per the standard practice adopted by ONGC, before making remittance to foreign suppliers/service provides, ONGC used to obtain a certificate from the tax authorities at Dehradun to apply the appropriate withholding rate and thereafter obtained a 'No Objection Certificate', on the basis of which remittance is made outside India. This practice continued for some time.

5. The assessee filed its return of income for the assessment years 2001-02, 2002-03 and 2003-04 on 31st December, 2003 voluntarily with the Assistant Director of Income Tax, Circle 2 (1), International Taxation, New Delhi. Likewise, for the assessment year 2004-05, the Singapore Company filed return on 14th September, 2004.



6. For all these years in the voluntary Income Tax Return filed by Singapore Company, it had disclosed Fees for Technical Services (hereinafter referred to as the FTS) income. The returns were processed by issuing notice under Section 143 (2) of the Income-Tax Act (hereinafter referred to as 'the Act') and ultimately different assessment orders were passed making various additions. Summary of the returns filed and income assessed by the Assessing Officer for these years is as under:

Assessment Year	Income declared by the Company	Income assessed by the Assessing Officer
2001-02	₹ 26,07,430/-	Addition of ₹ 2,36,15,935/- as business income. FTS income assessed at ₹ 96,85,586/-
2002-03	FTS income of ₹ 92,35,097/-	@ 20% under section 115A holding the income at ₹ 33,46, 61,049/-.
2003-04	FTS income of ₹ 11,100,491/-	Addition towards business income at ₹ 28,461,672/- and assessing FTS at ₹ 33,868,226/-
2004-05	FTS income of ₹ 17,522,950/-	Addition towards business income at ₹ 86,059759/- assessing FTS income at ₹ 25,346,740/-.

7. As is clear from the above, the Singapore Company filed volur return for the first time starting from assessment year 2001-02. According to the Assessing officer, return for the previous years namely assessment years, 1998-99,1999-2000, 2000-01 should also have been filed. Notices under Section 148 of the Act for all these three years were accordingly issued pursuant to which the Singapore Company filed its return declaring 'Nil' income for assessment year 1998-99 and 1999-2000. In respect of assessment year 2000-01, return was filed declaring an income of ₹280,00,213/-, the Assessing Officer had assessed the income for these years. However, the contention of the Singapore Company was that since it had acquired the energy business from M/s Cameroon Energies Private Limited only in the financial year 1999-2000 (corresponding to assessment year 2000-01), no income was earned by it in the assessment year 1998-99 and 1999-2000. Though, the Assessing Officer did not accept this plea and made the assessment, the CIT (A) granted the relief agreeing with the contention of the Singapore Company and his order has been affirmed by the ITAT as well. Insofar as assessment year 2000-01 is concerned, against the declared income of Rs. 28,00,120/-, the Assessing Officer made addition of Rs. 5,135,140/- towards business

income and accepting the FTS income as declared by the Singa Company.

8. With this, we revert back to the assessment years 2000-01 to 2004-05 which are the subject matter of appeals filed by the Singapore Company. It can be seen from the returns filed by the Company that during this period, the Singapore Company has been offering its service fee income on cash basis as "Fees for Technical Services" under Section 9 (1) (vii) read with Section 115A of the Act, Section 43 (2) and Section 145 of the Act. According to the Company, the income from supplies is not taxable in India on the ground that it does not have any Permanent Establishment in India. This plea was not accepted by the Assessing Officer who held that the Singapore Company had Permanent Establishment (PE) in India and for this purpose income from supplies made by the company is taxed in India as business income. The Assessing Officer while making additions on this account in respect of these assessment years had returned the following findings:

(i) The appellant has a business connection/PE in India.

(ii) The supplies and services are intricately and inextricably linked with each other.

(iii) The AO taxed business profits from supplies by attributing 100% of the profit (and 75% of the profits in AY 2004-05) to the Business connection/PE by applying profit earned by M/s Rolls Royce Plc, an entity incorporated in the UK. However, he accepted the position taken by the appellant that service fees shall be subject to tax at the rate of 20% plus surcharge and cess even though he alleged that services and supplies are inter-related and they are effectively connected with the business connection/PE.

It would also been seen that the Assessing Officer did not accept the income from FTS as declared by the assessee and made additions thereto. The reason, according to the Assessing Officer, was that the Singapore Company was liable to pay tax from its income from services and supplies on accrual basis.

9. The Singapore Company filed separate appeals for these years which were disposed of by the CIT (A) vide consolidated orders dated 19th April, 2008. Vide this order, the CIT (A) granted partial relief to the Singapore Company in the following manner:-

a) profits should be attributed to PE in India, for the assessment years 2000-01 and 2001-02, at 10% of net profit, and for 2002-03, 2003-04 and 2004-05 at 25%.

b) No income is chargeable to tax in the hands of the company during the assessment years 1998-99 and 1999-2000 since it did not earn any income during these periods.

Against the above consolidated order of the Ld. CIT (A), the appellant filed the appeals before the Tribunal. The revenue has also filed appeals against the Ld. CIT (A)'s order in reducing the rate of profit attributable to PE in India in A.Y. 2000-1 to 2004-05.

10. In the appeals filed by the assessee before the Tribunal, the first issue before the Tribunal was as to whether FTS was taxable on accrual basis or on cash basis. The Singapore Company had offered the income 'receipt or cash basis' on the ground that this was the method of accounting followed by it. The Assessing Officer had not accepted the same in respect of assessment year 1998-99 and 1999-2000 holding that the method of accounting of Singapore Company should have been mercantile basis as per the Income Tax Law and the income of the company was accordingly re-casted. Insofar as assessment year 2002-03 and 2004-05 are concerned, the Singapore Company had declared the receipts from Indian companies as FTS and subject it to tax under Section 115 A of the Act. Again, the Assessing Officer held that the Singapore Company was supposed to maintain the accounts on accrual or

mercantile basis. This view of the Assessing Officer was affirmed by CIT (A) and the ITAT has also upheld the same in the impugned order. We may add at this stage itself that this issue does not arise in the present appeals as the decision of the ITAT in this aspect has been accepted by the Singapore Company.

11. The second issue taken up by the ITAT pertained to the validity of Assessing officer's action in initiating the proceedings under Section 147 of the Act in respect of assessment year 1998-99 to 2001-02. We have already pointed out above that in respect of these three years, the assessee /Singapore Company had not filed any return and the returns were filed after the notices under Section 148 of the Act were issued. The CIT (A) held that reopening of the assessment by invoking the provisions of Section 147 of the Act was valid which is upheld by the ITAT also. Again, this is not the subject matter of the present appeals.

12. The bone of contention in the appeals filed by the Singapore Company are the findings returned by the ITAT on the questions as to whether the Singapore Company had no business connection or Permanent Establishment in India insofar as its business activity of supplying the goods or spare parts to Indian customers is concerned. As

already indicated in brief above, the Assessing Officer had held that assessee is having PE in India and, therefore, the income earned by it from supplying the goods or spare parts to Indian customers was taxable in India. This view has been upheld by the CIT (A) as well as the ITAT. We may now proceed to give some details for forming such a view.

13. As pointed out above, though in the income tax return filed by the Singapore Company it had shown income from maintenance services as Fee for Technical Services (FTS) and paid tax @ 20% thereupon as per the provisions of the Income Tax Act, it had not declared any income for supply of equipments made to the Indian clients on the ground that it had no PE in India and, therefore, its business income from supply of spare parts is not chargeable to tax in India.

14. The AO, on the other hand, was of the view that it was the responsibility of the assessee company flowing from the supply of original equipment supplied by the other companies belonging to Rolls Royce Group, to supply spare parts to the Indian clients, whom the equipments were supplied by the other companies of Rolls Royce Group. In other words, the AO had taken a view that since the assessee company was discharging the contractual obligation of the supplier of the original

equipment, providing maintenance services as well as making supp spares by the assessee company was incidental to the supply of original equipment made by the other company of Rolls Royce Group. The AO had also taken a view that such services and spares cannot be procured by the India customer from any independent party, and it was only the assessee, who could provide such services to the Indian clients. The AO, therefore, had taken a view that the assessee company has business connection and source of income in India in terms of Section 9 (1 (i) of the Act. The A.O. has also taken a view that the assessee company has permanent establishment in India as well. The AO, therefore, held that by reason of existence of business connection and source of income and permanent establishment in India, the assessee is liable to pay tax in respect of income earned on supply of spares as business profit. It was further observed by the AO that assessee has an executive agent in India in the form of ANR, whose only source of income in India is from the assessee, and M/s ANR was responsible to the assessee and was not doing any activities other than what were directed by the assessee. The AO, therefore, had taken a view that the assessee has a business connection or PE in India in the form of ANR.

15. The AO further stated that the income of the assessee maintenance services accrues or arise in India by deploying engineers and personnel for undertaking maintenance of the equipment at the sites of the Indian clients located in India, and the maintenance activities cannot be isolated from the supply of spares. He further observed that supply of spares and services or maintenance of the equipments are inextricably linked to each other as the service engineers would certainly required spares parts to be replaced or overhauled.

16. The AO further stated that the assessee company has placed one Mr. Venketaramana as Exclusive Regional Sales Manager in India and, thus, income of the assessee from supply of spares accrue or arise in India from the activities of its Sales manager as well.

17. The CIT (A) agreed with the A.O's view. In the light of various points raised by the A.O. the CIT (A) held that the assessee company has a PE in India on following counts:-

(i) That the assessee has a source of income in India;

(ii) That the assessee has established a complete set up of facility for providing services to the customers, during the whole year; and those services and facilities were provided in respect of the original equipment supplied by some

other who are related/associated concern of the assessee for a period of more than 30 days.

(iii) That office of the ANR was used for receiving and soliciting orders;

(iv) M/s ANR is a dependent agent permanent establishment of assessee.

18. In other words, the CIT (A) took a view that the Singapore company has a permanent establishment in India within the meaning of Article 5 (1), 5(2) (f), 5 (2) (i), 5 (5), 5(6) and 5(8) of the DTAA.

19. In the appeals filed by the Singapore Company against the aforesaid findings of the CIT (A), it was submitted that ANR Associates private Ltd. (ANR) was an independent entity and was not related to the Singapore Company at all; ANR had various other clients from where it was earning the revenue and the appellant was the sole customer; ANR did not have the power to negotiate and conclude the contracts on behalf of the Singapore Company and the transactions between the ANR and the Singapore Company were on principal to principal basis. Therefore, ANR could not be treated as an independent agent, or Permanent Establishment of the Singapore Company. In any case, even if ANR presumed to be the PE of the Singapore Company, fee of US $ 40,000/-

per annum paid by the Singapore Company to ANR was Arms Le
Price (ALP). The said fee was already taxed at the hands of the ANR and, therefore, having regard to the provisions of the Double Taxation Avoidance Agreement (DTAA), there was no question of taxing any income at the hands of the Singapore Company in respect of supplies made by it to Indian customers.

20. We would like to point out at this stage that on multiple grounds, the Assessing Officer and the CIT (A) had held that the Singapore Company had PE in India. Many of these grounds have not been accepted by the Tribunal. It has given detailed reasons for knocking out the various basis adopted by the Assessing Officer for forming the opinion that the assessee had PE in India. For example, the ITAT has not accepted that merely because the Singapore Company is a part of a Group Company of Rolls Royce which has world vide operation, because of other operations of the Group Companies, the Singapore Company shall be deemed to have PE in India. According to ITAT the Singapore Company, like each company belonging to Rolls Royce Group is a separate entity and a separate tax assessee. Likewise, merely because some income has accrued to the Singapore Company in India from deployment of Engineers and personnel in undertaking the maintenance

and service of equipments at the sites of Indian clients located in Ind not ground to hold that it has PE in India. In the absence of any material showing and indicating that the contract for providing service and supplying spare parts are inter-connected and related. Similarly, findings of the Assessing Officer that Singapore Company shall be deemed to have Permanent Establishment in India to carry on the business through PE as it has been providing service facility in India for a period of 183 days in a fiscal year to ONGC and GAIL in connection with their activity of exploration, exploitation or extraction of material oil in India has been upset and turned down by the Tribunal holding that no material has been brought on record to prove and establish the same.

21. In fact, the only reason given by the Assessing Officer, accepted by the CIT (A) and affirmed by the ITAT for holding that the Singapore Company has PE in India is premised on the relationship between the Singapore Company with ANR, which makes the ANR as the PE of Singapore Company within the meaning of Article 5 (1) and 5 (2) of DTAA between India and the Singapore, is that the said ANR is a dependent agent of the Singapore Company within the meaning of Article 5 (8) read with Article 8 and 9 of DTAA.

22. We would like to point out here that the Assessing Officer as well as the CIT (A) had *inter alia,* held that the activities of ANR are much more than those provided for in the contract entered into between the Singapore Company and ANR. The Assessing Officer had recorded in its order that the Singapore Company had paid the commission of 5% of the contract value to ANR over and above, the US$ 40,000/- per annum payable under the written contract made with ANR. This finding has not been accepted by the ITAT. It concluded that the Singapore Company paid commission @ 5% of sales value to ANR before the written agreement was entered into on and from 1.1.2002. From the date of agreement, instead of paying commission @ 5% of the total invoice value, a lump-sum commission of US$ 40,000/- was paid to ANR. There was no evidence to hold that in addition to this US$ 40,000/- the Singapore Company was paying commission @ 5% on sale as well and claim of the Revenue that activities of ANR are much more than what is provided for in the agreement has also held to be wrong and was rejected.

23. After holding so, the Tribunal proceeded to discuss the question as to whether in the light of nature of activities carried out by the ANR as per the agreement, the Singapore Company can be said to have a PE in India in the form of ANR. The Tribunal after extracting the terms of the

agreement as to the nature of the services to be provided by ANR to Singapore Company and terms relating to "Limitation and Restrictions", "Representations and warranties of ANR", "Confidentiality" etc. in the light of provisions of DTAA held that relationship between the Singapore Company and ANR was not on principal to principal basis. Instead, the ANR acted as a dependent agent of Singapore Company and its activities were controlled by the Singapore Company. The ANR was, therefore, could not be regarded as an agent of an independent status within the meaning of Article 5 (9) of DTAA. For arriving at this conclusion, the Tribunal has, *inter alia*, recorded the following findings:-

> (1) Activity of ANR Associates during the period from 1.1.2002 was more or less similar what has been stipulated in the written agreement dated 1.1.2002, except the amount and basis of payment of commission/ remuneration to ANR.
>
> (2) The purpose of entering into agreement or understanding that ANR was the replacement of Singapore Company to have certain in-country support services in relation to the promotion and supporting its project in India. ANR was chosen since it has the infrastructure in India to provide such services.
>
> (3) ANR was to provide services in relation to promoting and supporting the sale of 'projects' in India. The expression 'products' has been deleted in the Schedule A to the agreement which has two sections. Section-I is with regard

to new unit products used by oil and gas industries and Section-2 is with regard to the customers service products under oil and gas industry.

(4) Clause 8.2 of the Agreement imposed certain limitations and restrictions upon ANR with stipulation that it shall Act exclusively for the assessee in relation to the promotion of its product and shall not directly or indirectly assist any other person, the firm or company competing with the assessee or shall not advice or represent or be concerned with or interested in the business of any such person, firm or any company in India.

24. Thus, ANR was prohibited from promoting identical products of any such person, firm or company competing with the firm of assessee. These unusual restrictions imposed upon the ANR would suggest that ANR never intended to work as an independent agent in its ordinary course of business. Reading the agreement as a whole would suggest that ANR was a Singapore Company exclusively in respect of nature of products mention in Schedule A of the agreement. Thus, this would suggest that ANR was not acting in the independent status and in the ordinary course of their business while rendering to the assessee in-country support services of the nature described in condition 3 of the agreement in relation to promote and supporting the sale of products in India.

25. As per Clause 5 of the agreement, ANR was supposed to instructions and advice from, and make the services available to the Singapore Company through Mr. Sudhir Mayor for the products identified in Section 1 of Schedule-A and Mr. Dave Klug for products identified in Section-2 of Schedule A or other nominees. Agreement also provided that Mr. Robert Turner will only liaison on behalf of the Singapore Company.

26. Thus, the ANR's activities was subject to close supervision of the Singapore Company as it was to report to take instructions and advice from and make the services available to Singapore Company through Mr. Sudhir, Mr. Dave and Mr.Robert Turner. Consequently, ANR has to perform its services under the exclusive control and detail instructions of the Singapore Company which goes to suggest lack of legal independents on the part of ANR.

27. According to the ITAT, the ANR was the sole agent of the Singapore Company and it was "almost wholly" earning from Singapore Company. Likewise, the Singapore Company was the client of ANR. This conclusion was drawn from the circumstances that though it was stated that the ANR was providing services to other companies and was earning commission from them, the extent of service rendered by ANR and the amount of

commission had not been disclosed. Only a certificate was given by by rendering services and earnings commission from other companies which were not sufficient to prove and establish that ANR was not getting "almost wholly" on behalf of the Singapore Company. The effect and difficulties about the services rendered and commission earned from other companies was within the knowledge of the ANR but the Singapore Company has chosen not to collect this information and given to the authorities, therefore, adverse inference was to be necessarily drawn when Singapore Company has failed to furnish any such documents as requested by the Assessing Officer.

28. Even the commission of US$ 40,000 per annum paid by the Singapore Company to ANR was not at arm's length payable to the agent had not termed with reference to the value of foreign products sold in the relevant year. Prior to 1.1.2002, commission was being paid @ 5% of invoice value, which had now been changed to lump-sum amount of US$ 40,000/- payable annually. This sort fixation of remuneration is usually not done between two independent parties in any uncontrolled transaction. The remuneration payable, therefore, seems to be in the nature of transaction controlled by the Singapore Company and cannot be considered to be made on arm's length. More so, when Singapore

Company had not furnished any instance of transaction entered between the two independent parties in uncontrolled manner in support of its contention that remuneration of lump-sum amount of US$ 40,000/- was determined at arm's length.

29. On the basis of the aforesaid findings the ITAT has summarised the activities of ANR in connection with the Singapore Company as under:

> "(i) That ANR is maintaining premises in India to carry out its obligation as an agent of the assessee company.
>
> (ii) ANR exclusively or almost wholly carries out the business on behalf of the assessee at their premises in India.
>
> (iii) The activities of ANHR includes promotion of products of the assessee, maintaining relationship with customers and potential customers of the assessee with regard to their equipments need.
>
> (iv) Making liaison with operators of equipments, which has been sold to oil and gas industry.
>
> (v) Making customers aware of suitable products sold by the assessee company.
>
> (vi) Arrangements of sales presentation and demonstration for assessee's customers.
>
> (vii) Assisting assessee in creating technical and commercial environment about its products required in oil and gas industry in India.
>
> (viii) Providing logistic services to the assessee.

> All these activities have been provided by ANR to the assessee in India from its fixed place of business maintained in India. This makes it clear that ANR or its offices are used by the assessee company for soliciting order by performing the activities or services mentioned in para 3 and 4 of the agreement. It also makes it clear that ANR is acting almost exclusively for assessee in relation to promotion of assessee's products in India.
>
> Therefore, in the light of the aforesaid factors discussed and pointed out by us, that is, (i) that ANR was not acting in its ordinary course of business while acting for the assessee to provide services as per agreement dated 01.01.2002, and (ii) an extensive control was being exercised by the assessee upon, ANR who was bound to take instructions and advice from the assessee or its representative and (iii) that assessee has been rendering services almost wholly for the assessee, and (iv) and the transaction between them is not at Arm's length, we hold that ANR is not an independent agent within the meaning of para (9) of the Article 5 of DTAA between India and Singapore."

30. On this basis, the ITAT concluded that Singapore Company had Permanent Establishment in India within the meaning of Article 5 (1) of DTAA through its dependent agent ANR. The Tribunal has also held that even in terms of Article 5 (8), Article 5 (9) of the DTAA, ANR would be deemed to be the "Permanent Establishment" in India. This position is discussed in para 98 of the impugned order which reads as under:

"In the instant case, it is an admitted position that clause (a) and (b) of para (8) of Article 5 does not apply inasmuch as there is no material or evidence brought on record to show and establish that the ANR habitually exercised an authority to conclude contracts on behalf of the assessee company in India or ANR habitually maintained in India a stock of goods or merchandise from which it regularly delivers goods or merchandise on behalf of the assessee company. However, having regard to the fact that ANR has been rendering services to negotiate and secured orders in India since long it can be said that ANR associates habitually secured orders in India wholly or almost wholly for the assessee company. This would be established from the very fact that prior to 01.01.2002, the assessee used to get commission at the rate of 5% of invoice value and that commission was deducted by ONGC from invoice value payable to assessee company and then paid to ANR. In other words, a role played by ANR in securing orders from ONGC on a consideration of % of invoice value was even recognized by the assessee's customer, namely, ONGC. The payment of 5% of commission of sale value is substantial amount having regard to the over all net profit of about 12 to 14% earned by the assessee from supply of spares. The agent ANR had a relation or connection with ONGC with regard to contract of supply of spares by assessee company is well established from the fact that even the commission payable to ANR was directly deducted by ONGC from sale value and then paid to ANR. Further, the very fact that remuneration for the services by ANR to assessee company in any year has been fixed at an fixed fee of US$ 40000 from 01.01.2002 also suggest that ANR was dependent agent as he agree to remuneration at a fix amount of US$ 40000 as against earlier arrangement of payment of specific percentage of sale value of

> items or products sold by assessee company to Indian clients. The nature of overall services rendered by ANR to assessee company as described in clause 3, 4, and 5 read with clause 8,9 and 10 relating to limitations and restrictions, representations and warrantees of ANR and confidentiality would show that ANR was instrumental in securing orders in India for the assessee company and was acting at the instructions of assessee company. Therefore, ANR shall be deemed to be agency PE in India within the meaning of para (8) and (9) of Article 5 of the Treaty."

31. After giving the aforesaid findings, the Tribunal proceeded to determine the income that would be chargeable to tax in the hands of Singapore Company in India from the business activity of the sale of spare parts in view of Article 7 of the DTAA which provides that "so much of the profit as is attributable to PE in India can be taxed in India". As lump-sum commission of US$ 40,000 was not treated at arm's length, the Tribunal went into the issue of percentage of the income and arrived at a conclusion that the amount of profit attributable to PE at 10%, as determined by CIT (A) would be proper as against the Assessing Officer's view that it should be 25%. As a result, the order of the CIT (A) on this aspect has been sustained and appeals filed by the Revenue for increase of the profits from 10% to 25% have been dismissed.

32. In the appeals filed by the Singapore Company, the appellant confined its and challenge to the findings of the ITAT that ANR is a Permanent Establishment of Singapore Company in India as per Article 5 (9) of the DTAA between India and Singapore.

33. In the alternative, it is also argued that order of the Tribunal is also questioned where it is held that the lump-sum commission of US$ 40,000 per annum is not at arm's length and fixing 10% of the profits on sales of the spare parts made in India by the Singapore Company is to be carried out by ANR in India and chargeable to tax in India.

34. These appeals were admitted on as many as seven substantial questions of law reproduced below:-

> "a. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant has a business connection in India?
>
> b. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the Appellant has a Permanent Establishment in India as per Article 5 of the DTAA between India and Singapore?
>
> c. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant partly carried on a business in India through the premises of ANR under Article 5 (1) of the DTAA between India and Singapore?

> d. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant should be regarded as having a permanent establishment by way of premises used as a sales outlet or for soliciting and receiving orders in India under Article 5 (2) (i) of the DTAA between India and Singapore?
>
> e. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that ANR should be regarded as a Dependent Agent Permanent Establishment of the Appellant under the Article 5 (8) of the DTAA between India and Singapore on the premise that ANR habitually secures orders wholly and mainly on behalf of the appellant?
>
> f. Whether in the facts and circumstances of the case, the ITAT grossly erred in concluding that ANR has not been compensated at arm's length price, without adequate basis to arrive at such a conclusion?
>
> g. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that 10 percent of the profits on sales of spare parts made in India by the Appellant should be attributable to the activities carried out by ANR in India and should be chargeable to tax in India under the Act?."

35. However, focus of learned counsel for the appellant remained on the aforesaid two aspects viz question of law at 'e' and 'f'. Infact, Mr. Ganesh, learned Senior Counsel appearing for the appellant submitted that the issue of arm's length price be decided first because of the reason that if it is held that the payment of aforesaid commission to the ANR was

at arm's length, the issue as to whether the Singapore Company a through ANR as its PE in India or not would be rendered academic. He thus, opened his arguments on the alternate issue of ALP and in fact entire emphasis of Mr. Ganesh was to convince this Court that the commission payable was at ALP.

36. In view of the aforesaid approach of the learned counsel for the appellant limiting scope of its challenge to the ITAT order, we proceed on the basis that the assessee has business connection in India through ANR. It is also an admitted fact that ANR is an agent of the assessee India. In these circumstances, we answer questions of law no. 'a' to 'd' in favour of the Revenue and against the assessee.

37. In this backdrop, the only two issues that need to be decided are:-

(i) Status of ANR – Whether dependent agent within the meaning of Article 5 (8) of DTAA.

(ii) The payment of US$ 40,000 per annum made by the assessee to the ANR can be treated as ALP.

38. On this, questions of law 'e' and 'f' are formulated. If answer to any of these questions is in favour of the assessee, then no further discussion is needed. However, if these questions are decided against the assessee

then the last question would be as to whether 10% of the profi sales on spare parts made in India held as exigible to tax by the ITAT is wrong. We may again point out here that the Assessing Officer had attributed 25% of profits on sales of spare parts to the activities carried out by the ANR as chargeable to tax which was reduced to 10% by the CIT (A). The Revenue has also filed appeals challenging this part of the order of the Tribunal as Revenue claims that order of the Assessing Officer fixing 25% profits on sales on spare parts was proper and valid. Therefore, while discussing the question of law no. 'g', appeals of the Revenue shall also be taken into consideration.

<u>Question of Law-'e'</u>

> "Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that ANR should be regarded as a Dependent Agent Permanent Establishment of the Appellant under the Article 5 (8) of the DTAA between India and Singapore on the premise that ANR habitually secures orders wholly and mainly on behalf of the appellant?

39. This question becomes relevant having regard to the provisions of Article 5 of the DTAA between India and Singapore, the relevant provisions of this Article is as under:-

ARTICLE 5 – Permanent Establishment

1. For the purpose of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:-

    (a)……
    (b)……
    (c)……
    (d)……
    (e)……
    (f)……
    (g)……
    (h)……
    (i) A premises used as a sales outlet or for soliciting and receiving orders;

    (j)…

3……
4……
5…..
6….

7……

8. Notwithstanding the provisions of paragraph 1 and 2 , where a person – other than an agent of an independent status to whom paragraph 9 applies – is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if-

(a) he has and habitually exercises in that 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;

(b) he has no such authority but habitually maintains in the first-mentioned State a Stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprise controlling, controlled by, or subject to the same common control, as that enterprise,

9. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State **merely because it carries on business in that other State through a broker,** general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are **devoted wholly or almost wholly on behalf of that enterprise** itself or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.

40. The endeavour of the assessee is to demonstrate that ANR is an agent of an independent status and, therefore, paragraph-8 of this Article have no application. Additionally, it was also argued that ANR had not undertaken any of the activities specified in said paras 8 (a) to (c) of para 8 of Article 5 and for this reason also, this para have no application. It was further argued that the activities of ANR as an agent were not

devoted wholly or almost wholly on behalf of the assessee and conditions stipulated in para 9 of Article 5 are not fulfilled and on this reckoning also ANR would not be considered as an agent of independent status within the meaning of said para.

41. We have already taken note of the reasons which are given by the Tribunal in support of its findings that provisions of para 8 & 9 of Article 5 stand attracted in the instant case.

42. His submission was that the Tribunal had given two reasons for drawing the conclusion which were totally immaterial having regarding to the provisions of Article 5 (9). In this behalf, he referred to the following discussion in the Tribunal's order containing these reasons:

> (1) The Tribunal had held that ANR was prohibited from taking competitive products. In the agreement, certain limitation and restriction has also been imposed upon ANR vide condition 8.2 that ANR associates shall act exclusively for assessee in relation to the promotion of its product and shall not directly or indirectly assist any other person, the firm or company competing with assessee or shall not advice or represent or be concerned with or interested in the business of any such person, firm or company in India. In other words, in respect of the products mentioned in Section1 and 2 of Schedule-A, ANR was restricted to assist directly or indirectly any other person, firm or company competing with the assessee or directly or indirectly advice or represent or be concerned with or interested in the business of any other person, firm or company in India competing with assessee. It is,

thus, clear that ANR was prohibiting from promoting the identical products of any other person, firm, or company competing with assessee. This unusual restriction imposed upon ANR would suggest that ANR never intended to act as an independent agent in the ordinary course of its business. Reading the agreement as a whole would suggest that ANR has been rendering services to assessee company exclusively in respect of the nature of the products mentioned in Schedule A of the agreement, and has been restrained or prohibited from assisting, advising or representing any other person, firm or company competing with the assessee in the same line of business. This short of restriction and limitation imposed upon ANR associates would suggest that ANR associates was not acting in the independent status and in the ordinary course of their business while rendering to the assessee in-country support services of the nature described in condition No.3 and 4 of the agreement in relation to promote and supporting the sale of products in India, details of products being described in Schedule-A of the agreement. Therefore, on this count, ANR cannot be regarded as an agent of an independent status within the meaning of para (9) of Article 5 of DTAA between India and the Singapore. Further, para (9) of Article 5 provides that when the activities of an agent of an independent status acting in the ordinary course of his business are devoted wholly or almost wholly on behalf of the enterprise itself or on behalf of that enterprise and other enterprises controlling, controlled, by, or subject same control, as that enterprise, he will not be considered an agent of an independent status within the meaning of para (9) of Article 5 of DTAA.

(2) The Tribunal also held that the assessee exercised extensive control over ANR as for various actions, the ANR was supposed to take instructions and advise from the representatives of the assessee. The discussion of the Tribunal in this behalf is reproduced as under:-

"It is pertinent to note that Clause-5 of the agreement dated 01.01.2002 between the assessee and ANR provides that ANR shall report to, take instructions and advice from, and make the services available to the assessee through Mr. Sudhir Mayor for the products identified in section 1 of Schedule A and Mr. Dave Klug for the products identified n section 2 of Schedule A, or their nominees. Mr. Robert Turner will handle liaison on all administrative aspects of this agreement on behalf of company. The assessee may change the person or persons nominated under this clause at any time by notice in writing to ANR. Further clause 8.2 of the said agreement provides that ANR shall act exclusively for the assessee in relation to the promotion of its products and shall not directly or indirectly assist any other person, firm or company competing with the assessee company or advice or represent or be concerned with or interested I the business of any such person, firm or company in India. This clause makes it clear that ANR is prohibited and restrained from handling identical products or goods for principal. As per the condition enumerated in clause -5 of the agreement, it is clear that his activities are subject to close supervision of the assessee company as in the said clause it has been provided that ANR shall report to, take instructions and advice from, and make the services available to the assessee through Mr. Sudhir Mayor for the products identified n section 1 of Schedule A and Mr. Dave Klug for the products identified in Section 2 of Schedule A, or their nominees, and Mr. Robert Truner will handle liaison on all administrative aspects of this agreement on behalf of company. The assessee may

> change the person or persons nominated under this clause at any time by notice in writing to ANR. This makes it clear that ANR has to perform his services under the extensive control and detailed instructions of the assessee company, which goes to suggest a lack of legal independence on the part of the ANR. Furthermore, the stipulations about representations and warranties of ANR and confidentiality, which has already been reproduced above, also indicate an extensive control exercised by the assessee company over ANR while ANR was acting for the assessee."

43. Mr. Ganesh, learned Senior Counsel appearing for the assessee rebutted those reasons by arguing that ANR was already an existing company and was not created by the assessee. The said ANR had its own infrastructure and its own business etc. before it entered into the agreement with the assessee. He submitted that Article 5 (9) was self-working and highly evolved provision and only those conditions mentioned therein was to be seen. According to him, the Tribunal committed fundamental error of law by giving its own reasons which were irrelevant in the context of Article 5 (9).

44. We are not impressed by that part of the submission of Mr. Ganesh where he argues that the Tribunal has taken into consideration those

aspects which are not relevant for the purposes of Article 5 (9). It is clear from the extracted portion of the Tribunal's order, that the focus of the Tribunal was entirely on Article 5 (9) and it was discussing as to whether the activities of ANR was devoted wholly or almost wholly on behalf of the assessee and further as to whether the assessee was exercising extensive control over the ANR. These very criteria are laid down in Article 5 (9) for the purposes of determining as to whether such an agent of independent status or not.

45. It would, however, be a different question as to whether the reasons given by the Tribunal are sufficient to hold that the criteria stipulated in Article 5 (9) treating ANR as dependent agent are satisfied. Coming to this aspect, the argument of Mr. Ganesh was that merely because ANR was prohibited from taking a competitive products would not mean that it was an agent of independent status. What was to be seen was that the 'activities' of ANR are devoted wholly or almost wholly on behalf of the assessee. According to Mr. Ganesh, ANR had many other activities and was doing business for many other parties. Agency of the assessee held by ANR was only one of those many activities. This contention of the assessee is not accepted by the Tribunal as according to the Tribunal the

assessee had not stated as to the extent of services rendered by ANR to other companies as well as the amount of commission earned by ANR from them. The particulars of other clients and commission earned by ANR from them was within the knowledge of ANR but the assessee did not chose to collect the same and provide it to the Assessing Officer. The Tribunal further observed that the assessee failed to furnish all such details on requisition by the Assessing Officer. It was disputed by the learned counsel for the assessee that there was no such requisition made and the assessee was never asked to furnish such information. The fact remains that it was the contention of the assessee that the assessee was not the sole client of ANR and that activities of ANR were not devoted wholly or almost wholly on behalf of the assessee. The assessee produced a communication dated 18th January, 2007 addressed to it by ANR conforming that ANR had rendered services and had earned commission from companies other than the assessee during the final year 2003-04 and that the assessee was not the only source of income during the year. After this letter was produced, the Assessing Officer did not ask for further information. The learned counsel for the Revenue could not show anything to the contrary or dispute the fact that the Tribunal has gone on the wrong premise that the assessee failed to

furnish all such details even after requisitioned by the Assessing Off

It could not be denied that there was no such requisition made and the assessee was never asked to furnish any such information. On this wrong premise, the Tribunal has arrived at wrong conclusion.

46. We may record here that Mr. Ganesh produced the Income-Tax Returns of M/s ANR for certain relevant years which show that ANR had been rendering services to other companies as well from where it had been earning commission and the commission earned from the assessee was not the only source of income during the year. We do not want to comment more. The question whether ANR has income from other clients as well and the extent of such income is very relevant to decide as to whether the criteria stipulated in Article 5(9) is satisfied or not. Since the Assessing Officer did not look into the matter from this angle and the ITAT also disposed of the issue deciding against the assessee on wrong premise, we are of the opinion that for this limited issue matter needs to be remanded back to the Assessing Officer. The Assessing Officer shall decide the question of applicability of Article 5 (9) as to whether the ANR was providing services t companies other than the assessee as well and had substantial income from those other

companies and whether the company stipulated in Article 5 (9) na
ANR was wholly or almost wholly working on behalf of the assessee will have to be determined afresh by the Assessing Officer.

47. The assessee is permitted to file the evidence in the form of Income Tax Return or otherwise on this issue. We may, however, make it clear that onus would be on the assessee to show that ANR had been rendering services and earning commission from other companies on the basis of which it cannot be said that the ANR devoted wholly or almost wholly on behalf of the assessee. These matters are thus remanded back to the Assessing Officer for fresh adjudication.

Question of Law - 'f'

> Whether in the facts and circumstances of the case, the ITAT grossly erred in concluding that ANR has not been compensated at arm's length price, without adequate basis to arrive at such a conclusion?

48. The submission of the assessee in this behalf is that even if the ANR is to be treated as PE of the assessee company in India as per Article 7 (2), only that income is to be treated as business profits which is reasonably attributed to the Permanent Establishment namely the

profits which Permanent Establishment might be accepted to make were a distinct and separate enterprise. It was argued that the remuneration of US$40,000 per annum paid by the assessee to ANR could be treated as the profit on reasonable basis. It was argued that the question of ALP could arise only there was a connection between the two. Even if the ANR was PE of the assessee as that had no bearing o the fixation of the price i.e. commission agreed to between the parties. Stress was laid down to the fact that there was no way the assessee could dictate the commission to be charged by ANR. ANR was negotiating at third party in the market place and, therefore, sum of US$ 40,000 agreed to between the parties which was payable by the assessee to ANRT was at arm's length and could be treated as reasonable. In support of his submission, he relied upon the judgment of the Supreme Court in the case of *DIT (International Taxation)* Vs. *Morgan Stanley and Co.* Inc. (2007) 292 ITR 416 (SC) and specifically referred to paras 29,31 and 32 of the said judgment which reads as under:

> "29. As regards determination of profits attributable to a PE in India (MSAS) is concerned on the basis of arm's length principle we have quoted Article 7(2) of the DTAA. According to the AAR where there is an international transaction under which a non-resident compensates a PE at arm's length

price, no further profits would be attributable in India. In this connection, the AAR has relied upon Circular No. 23 of 1969 issued by CBDT as well as Circular No. 5 of 2004 also issued by CBDT. This is the key question which arises for determination in these civil appeals.

31. Article 7 of the U.N. Model Convention inter alia provides that only that portion of business profits is taxable in the source country which is attributable to the PE. It specifies how such business profits should be ascertained. Under the said Article, a PE is treated as if it is an independent enterprise (profit center) dehors the head office and which deals with the head office at arm's length. Therefore, its profits are determined on the basis as if it is an independent enterprise. The profits of the PE are determined on the basis of what an independent enterprise under similar circumstances might be expected to derive on its own. Article 7(2) of the U.N. Model Convention advocates the arm's length approach for attribution of profits to a PE.

32. The object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2) not all profits of MSCO would be taxable in India but only those which have economic nexus with PE in India. A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the PE in India. The quantum of taxable income is to be determined in accordance with the provisions of I.T. Act. All provisions of I.T. Act are applicable, including provisions relating to depreciation, investment losses, deductible expenses, carry-forward and set-off losses

etc. However, deviations are made by DTAA in cases of royalty, interest etc. Such deviations are also made under the I.T. Act (for example: Sections 44BB, 44BBA etc.). Under the impugned ruling delivered by the AAR, remuneration to MSAS was justified by a transfer pricing analysis and, therefore, no further income could be attributed to the PE (MSAS). In other words, the said ruling equates an arm's length analysis (ALA) with attribution of profits. It holds that once a transfer pricing analysis is undertaken; there is no further need to attribute profits to a PE. The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to the PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporate on the basis of the concept of Economic Nexus is an important feature of Attributable Profits (profits attributable to the PE)."

49. He also referred to the judgment of the Bombay High Court in *Sattellite (Singapore) PTE Ltd*. Vs. *Deputy Director if Income-Tax, International Taxation and another* (2008) 307 ITR 205 (Bom) wherein the Court held that when an agent in India was taxed on the fare value of activities in India, the same could not be taxed all over again in the hands of the assessee as being income attributable to deem permanent establishment. This very Treaty between Singapore and India was interpreted in the following manner:

> "From a reading of Article 7(1) of the DTAA it is clear that the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. The profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment. In para.2 while determining the profits attributable to the permanent establishment the expression used is "estimated on a reasonable basis". The DTAA does not refer to arms length payment. The principles contained in the matter of income from international transaction on an arms length price are contained in Section 92 of the Income Tax Act. The principles have been clarified by the Finance Act, 2001 as also Finance Act, 2002. From the order of the C.I.T. which has been accepted it is clear that the Appellant herein has paid to its P.E. on arms length principle."

50. There is no quarrel if it is a fair price paid by the assessee to AN the activities of the assessee in India through its PE namely ANR and the said price i.e. US$ 40,000 per annum has already been taxed in India at the hands of ANR, then no question of taxing the assessee again would arise. However, on the facts of this case, we are of the opinion that Mr. Sabharwal, learned counsel for the Revenue rightly argued that the judgment of Supreme Court in ***Morgan Stanley & Co.*** and Bombay High Court in ***Set Satellite (Singapore) PTE Ltd***. Vs. ***Deputy Director of Income-Tax, International Taxation and another*** *(supra)* would not apply to the facts of this case. In ***Morgan Stanley***, the Supreme Court accepted the payment as reasonable and fulfilling the ALP criteria only because the remuneration paid to the agent in India was justified by a Transfer Pricing Analysis. This Transfer Prices Analysis (TPA) is to be under take4n by invoking the provisions of Section 92 of the Act. Similar was the position in ***Set Satellite*** *(supra)* No such exercise is done in the instant case. The entire thrust of Mr. Ganesh was that ANR was a third party and had negotiating and could not be dictated by the assessee insofar as commission paid by the assessee to ANR is concerned. This argument may look attractive when considered in isolation. However, the surrounding facts and circumstances under which the aforesaid

commission came to be fixed would negative the submission of Ganesh. The agreement in question under which aforesaid commission of US$ 40,000 per annum was fixed, was dated 1st January, 2002 made effective from that date. Prior to this agreement executed between the parties in writing, the arrangement between the assessee and ANR profit for 5% commission of invoice value by the assessee to ANR on the sales. The Tribunal thus held that this sort fixation of remuneration is usually not done between two independent parties in any uncontrolled transaction. The remuneration payable, therefore, seems to be in the nature of transaction controlled by the Singapore Company and cannot be considered to be made on arm's length. More so, when Singapore Company had not furnished any instance of transaction entered into between the two independent parties in uncontrolled manner in support of its contention that remuneration of lump-sum amount of US$ 40,000/- was determined at arm's length.

51. From the aforesaid it is clear that the assessee could dictate the terms of the payment by altering the same and reducing it to the US$ 40,000 per annum from 5% of invoice value when assessee found that on the basis of 5% total commission payable could be much higher. This clearly leads to the inference that the assessee was in a position to

dictate the terms and in the absence of any Transfer Pricing Analys the Transfer Pricing Officer in the instant case, it cannot be said that such commission could fit the description of "reasonable profits" within the meaning of Article 7 (2) of DTAA.

52. FAR formally takes into consideration the Functions, Assets used and Risk involved. Thus to find out whether the agent is remunerative at arm's length, it is necessary to take into account all the risk taking function of the multi-national enterprise. If all the risk taking functions of the enterprise have not been taken into account, there would be a need to attribute profits to the PE for those functions/risks of the dependent agent that have not been considered. In the absence of such an exercise and any material on record on these aspects, we are of the opinion that the assessee has not been able to establish that the remuneration paid to ANR was equal to arm's length remuneration. We are of the opinion that the Assessing Officer in his order has rightly pointed out that the Supreme Court has referred to the "functions performed only the risk assumed by the enterprise" as distinguished from the functions performed and the risk assumed by the agent (who may constitute a dependent agent PE). The Assessing Officer has also quoted Rule 10B (2) of the Income-Tax Act

which provides that uncontrolled transaction shall be judged reference to following:-

> (a)....
>
> (b) the functions performed, taking into account assets employed or to be Employed and the risk assumed, by the respective parties to the transactions;
>
> (c) the contractual terms (whether or not such terms are formal or in writing) of the transaction which lay down explicitly or implicitly how the responsibility, risks are benefits are to be divided between the respective parties to the transactions:
>
> (d).....

53. No such exercise is undertaken in the present case. Further, it also needs to be highlighted that no plausible or justifiable reason is coming forthwith for changing the commission from 5% of the invoice value to US$40,000 per annum.

54. We thus, are quite in agreement with the conclusion of the Tribunal on this aspect and answer this question in the negative i.e. in favour of the Revenue and against the assessee.

<u>Question of Law 'g'</u>

> "Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that 10 percent of the profits on sales of spare parts made

> in India by the Appellant should be attributable to the activities carried out by ANR in India and should be chargeable to tax in India under the Act?."

55. Once we hold that commission of US$40,000 per annum does not represent the ALP, it is difficult to find fault in the order of the CIT (A) as well as ITAT fixing 10% of the invoice value for the purpose of taxation, inasmuch as the test is "profits accepted to make". The CIT (A) has pointed out in this behalf that the performance of ANR is to render support service in relation to promotion of sale and the products of the assessee in India and it has no authority negotiate, accept any order or make or vary any contract or to make any warranty or representation in terms of paragraph 8.1 of the Agreement. Therefore, the risk assumed by the ANR is limited. Even otherwise, it has not come on record that ANR has performed or assumed responsibility for anything beyond what is written in the agreement. ANR is performing the functions of promoting the sale, soliciting orders and those proceed relatable to market activity within India has to be attributable to the part played by the PE. On this account, very significant aspect noted by the two authorities below is that details of business transactions obtained from ONGC under Section 131 of the Act, in the form of various documents

supplied by ONGC revealed that supplies constitute the major part o business. Therefore, the income with respect to the supplies was to be computed in terms of Article 7 of DTAA and not under Article 12. This was the reason that the CIT (A) reduced the percentage from 25% to 10%. For this purpose, the CIT (A) referred to the judgment of Bombay Tribunal in the case of ***Ingersoll Rand Company*** *Vs.* ***ITO*** *4 ITD 654 (Bom.)* The ITAT while agreeing with the aforesaid view of CIT (A) additionally referred to the judgment of the Supreme Court in ***Annamali timber Trust Co.*** Vs. ***CIT*** 41 ITR 781 (SC) wherein it is held that there was justification only of apportionment of 10% of assessee's share of profit of the trading operations carried out in India when except entering into contract in taxable territory all other operations were carried out outside taxable territory. The CIT (A), however, held the view that attribution of income at the rate of 10% will not represent adequate attribution to all activities including services being performed in India by ANR. Thus, while restricting the attribution to 10% in respect of supplies, insofar as assessment year 2002-03,2003-04 and 2004-05 are concerned, the CIT (A) maintained the attribution of income @ 25% of the profits.

56. We are agree with the following conclusion of the ITAT:-

> "The order of the CIT (A) in applying the rate of 10% of the profit attributable to PE in India is, thus, upheld, which would be applied for all the assessment years under consideration. In other words, the CIT (A)'s order in applying the rate of 25% of the profit being allocated to PE in India in assessment years 2002-03, 2003-04 and 2004-05 has been reduced to 10% and the AO is, therefore, directed to compute the profit accordingly."

57. The issue is accordingly answered and, therefore, on this point, while rejecting the plea of the assessee, we also reject the appeals of the Revenue for taxing 25% of the invoice value.

58. As a result, the appeals of the assessee are partly allowed to the extent indicated while answering Question No. 'e' referring the matters back to the Assessing Officer for the limited purpose.

59. 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.

60. Since we have upheld the order of the ITAT in its entirety inclu[illegible] 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
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