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

Judgment delivered on: 08.10.2015

\+ **W.P.(C) 12856/2009 & CM No. 13676/2009**

ORACLE SYSTEMS CORPORATION … Petitioner

versus

ASSISTANT DIRECTOR OF INCOME TAX CIRCLE2(1) INTERNATIONAL TAXATION , NEW DELHI … Respondent

\+ **W.P.(C) 12870/2009 & CM No. 13692/2009**

ORACLE SYSTEMS CORPORATION … Petitioner

versus

ASSISTANT DIRECTOR OF INCOME TAX CIRCLE2(1), INTERNATIONAL TAXATION NEW DELHI … Respondent

Advocates who appeared in this case:

For the Petitioner : Mr M.S. Syali, Sr. Advocate with Mr Mayank Nagi, Advocate

For the Respondents : Mr Rahul Chaudhary, Senior Standing Counsel for the Revenue

CORAM:
HON'BLE MR. JUSTICE BADAR DURREZ AHMED
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

J U D G M E N T

JUSTICE BADAR DURREZ AHMED (ORAL)

1. These writ petitions are taken up together as they involve common questions. The writ petition being W.P.(C) No. 12870/2009 relates to the assessment year 2002-03 and W.P. (C) 12856/2009 pertains to the assessment year 2003-04. In both these writ petitions, the challenge is to the notices under Section 148 of the Income Tax Act, 1961 (hereinafter referred to as 'the said Act') as also to the orders disposing the objections. The section 148 notice was issued on 10.12.2008 in respect of assessment year 2002-03 and on 22.09.2008 in respect of assessment year 2003-04. The orders disposing the objections both dated 11.09.2009 in respect of both the assessment years were passed by the Dy. Assistant Director, Department of Income Tax rejecting the objections. Being aggrieved thereby, the present writ petitions have been filed.

2. The facts and circumstances are virtually identical in respect of both the assessment years and, therefore, we shall be referring to the facts of the assessment year 2002-03. In respect of this year, the original assessment under Section 143(3) was completed on 28.03.2005. More than 4 years from the end of the said assessment year, the impugned notice under Section 148 of the said Act was issued on 10.12.2008. Pursuant to the reasons having been furnished, the petitioner/assessee submitted its objections to the reopening of assessment on 31.08.2009 which, as indicated above, has been rejected by virtue of the impugned order dated 11.09.2009. The learned

counsel for the petitioner/assessee submitted that the impugned notices and the orders rejecting the objections are liable to be set aside, primarily on two grounds. First of all, it is contended that there has been a change of opinion and, secondly, it has been contended that the pre-conditions as stipulated in the first proviso under Section 147 have not been satisfied. Particularly, there is no failure on the part of the assessee to disclose fully and truly all the material facts for assessment.

3. Before we examine these two points, it would be necessary to set out the purported reasons which have been recorded for reopening of the assessment for the assessment year 2002-03. It may be pointed out at this juncture itself that the reasons recorded for 2003-04 are virtually identical. The reasons recorded for assessment year 2002-03 are as under:-

> ***Reasons recorded for reopening of assessment for AY 2002-03***
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> *"The assessee is a company incorporated in USA and into the business of supplying and replication of software. The assessment order u/s 143(3) of the Act was passed for the relevant assessment year on March 28, 2005 wherein it was established that the assessee has PE in India under Article 5 of the DTAA as well as 'business connection' u/s 9(1)(i) of the Act. The receipts of the assessee i.e. 'receipts from software' have been treated as 'royalty'. The receipts from software were treated as 'royalty' and have been taxed at gross basis as per the DTAA at the rate of 15%.*
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> *In view of the fact that the assessee has PE in India and that receipts from software were treated as 'royalty' the 'force of attraction rule' would be involved and the income in the nature of royalty should be attributed to the PE by virtue of this rule.*

Then as per section 44D of the Act no expenses are allowable and the receipts are to be taxed as royalty u/s 115A of the Act at the rate of 20% in place of 15% as done in the assessment order.

In view of the foregoing, I have reasons to believe that income chargeable to tax amounting to more than Rs. 1 lakh has escaped assessment within the meaning of section 147 of the Act. The case is covered under deemed escapement of income under Explanation – 2 to section 147 of the Act.

In view of the above, I further have the reasons to believe that the income of the assessee for the relevant year has escaped assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment for that year."

4. On going through the reasons, it appears that the focus seems to be on the royalty payments which have been received by the assessee from its Indian subsidiary (Oracle Indian Private Limited – OIPL). The allegation is that since the assessee has a Permanent Establishment (PE) in India and that the receipts by the assessee from licensing of the duplicate software has been treated as 'royalty' the 'force of attraction rule' would be attracted and that the income in the nature of royalty should also be attributed to the Permanent Establishment by virtue of the said rule. It is therefore, alleged that as per Section 44D of the said Act, no expenses would be allowable and the receipts are to be taxed as royalty under section 115A of the Act at the rate of 20% in place of 15% as was done and accepted in the assessment order. On the basis of this, it has been recorded by the Assessing Officer that he has reasons to believe that the income chargeable to tax in excess of Rs. 1

lakh had escaped assessment within the meaning of section 147 of the Act. It was also contended that the case was covered under the provision of deemed escapement of the income incorporated in Explanation -2 under Section 147 of the Act. At this juncture, it may be clarified that the petitioner has not raised any issue as to whether the deeming provision of Explanation – 2 is attracted in this case or not. In fact, we have proceeded on the basis that there is escapement of income as alleged by the Revenue although that may not have happened.

5. It is further noted in the recorded reasons that the escapement of income had occurred by reason of the "failure on the part of assessee to disclose fully and truly all material facts necessary for assessment for that year". It would be pertinent to point out that no so-called material fact has been specified which, according to the Assessing Officer had not been fully and truly disclosed. There is only a general statement that there has been failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment.

6. Taking up first point with regard to change of opinion, it may be pointed out that the Double Taxation Avoidance Agreement between India & USA, inter-alia, comprises of Article 7 of the DTAA between India and USA which speaks of business profits as under:-

"ARTICLE 7 - Business profits –

1. 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. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment ; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article."

7. On a reading of Article – 7 (1), it becomes clear that profits of the assessee, which is a US company, would be taxable only in USA until and unless and the assessee carries on business in India through a Permanent

Establishment situated here. It is further clear that if the assessee carries on business as aforesaid, the profits of the assessee may be taxed in India but only so much of them as are attributable to; (a) that permanent establishment; (b) sales in USA of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in USA of the same or similar kind as those effected through that permanent establishment. This is what is commonly known as the "force of attraction rule" and this is the rule which the Assessing Officer now wants to apply to the assessee upon reopening of the assessment proceedings.

8. We may also now notice the provisions of Article 12 of the DTAA between India and USA. The same, to the extent relevant, reads as under:

> "ARTICLE 12 – *Royalties and fees for included services – 1.* Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
>
> *2.* However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed :
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> (*a*) in the case of royalties referred to in sub-paragraph (*a*) of paragraph 3 and fees for included services as

defined in this Article [other than services described in sub-paragraph (*b*) of this paragraph] :

(*i*) during the first five taxable years for which this Convention has effect,

(a) 15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company ; and

(b) 20 per cent of the gross amount of the royalties or fees for included services in all other cases ; and

(*ii*) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services ; and

(b) in the case of royalties referred to in sub-paragraph (*b*) of paragraph 3 and fees for included services as defined in this Article that are ancillary and subsidiary to the enjoyment of the property for which payment is received under paragraph 3(*b*) of this Article, 10 per cent of the gross amount of the royalties or fees for included services.

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6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties or fees for included services arise, through a permanent establishment situated therein, or

> performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be shall apply."

9. Article 12 (1) clearly indicates that Royalty and Fees for included services arising in India and paid to a resident of United States may be taxed in USA. However, by virtue of the provisions of Article 12(2) such royalty and fees for included service could also be taxed in India. But there is a cap on the tax. The cap (as is applicable in the present case) is to the extent of 15% of the gross amount of royalty and fees for included services. This is so because in the present case Article 12 (2) (a) (ii) would be applicable according to the learned counsel for the assessee. Article 12(6) carves out an exception, in as much as, the provisions of paragraphs 1 and 2 of Article 12 would not apply where the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State (USA) carries on business in the other Contracting State (India), in which the royalties or fees for included services arise, "through a permanent establishment situated therein".

10. To appreciate the submissions made by the learned counsel for the petitioner, it is necessary to clarify that the assessee has paid 15% tax in

terms of Article 12 (2) (a) (ii) of the DTAA and this has been accepted by the Assessing Officer at the time of original assessment under 143(3) of the said Act. It is now the contention of the Assessing Officer that Article 12 (2) (a) (ii) would not apply because the royalties are connected with the Permanent Establishment of the assessee in India and therefore, by virtue of Article 12(6), the royalties should have been taxed under Article 7.

11. The learned counsel for the petitioner/assessee submitted that this would amount to a change of opinion. This is so because in the first instance when the original assessment was being framed, the Assessing Officer examined the attribution of income to the Permanent Establishment and while doing so attributed only that part of the income of the assessee which falls within Article 7. This was on the basis of the consideration that the assessee carried on two distinct businesses: (1) through its distribution unit and 2) its development unit. This fact is noticed in the assessment order itself. The royalties were attributable to the distribution unit whereas the profits and gains of business arising out of the development unit had been held attributable to the PE of the assessee in India. The distribution unit has not been held to be a PE of the assessee. Therefore, according to the learned counsel for the assessee, apart from the fact that on merits also the tax on royalties could only be taxed under Article 12 and not under Article 7, this aspect of attribution has been examined and noticed by the Assessing Officer during the original assessment.

12. The learned counsel for the respondent/Revenue submitted that the Assessing Officer has not examined this aspect at all and, had he done so, the 'force of attraction rule' would have been applied. We are unable to agree with the submissions made by the learned counsel for the Revenue for the simple reason that clause (6) of Article 12 itself carves out an exception. When the Assessing Officer has accepted the assessee's contentions that the royalty was to be taxed under Article 12 (2) (a) (ii) at the rate of 15%. It has to be presumed that the Assessing Officer's attention was attracted to the entire Article 12 of the DTAA. As stated above, that Article itself carves out an exception under clause (6) thereof. Therefore, it cannot be accepted, as is sought to be made out by the learned counsel for the Revenue, that the Assessing Officer had not applied his mind to this aspect of the matter. In this context, we may refer to ***CIT vs. Usha International Ltd:*** **(2012) 348 ITR 485 (Delhi).** A full bench of this Court clearly observed that there may be cases where the Assessing Officer does not and may not raise any written query but still the Assessing Officer in the first round/original proceedings may have examined the subject matter, claim, etc., because the aspect or question may be too apparent and obvious. The court also observed that in such cases it would be contrary and opposed to normal human conduct to hold that the Assessing Officer in the first round did not examine the question or subject-matter and form an opinion. Of course, the cases have to be examined individually. In the present case, having examined all the relevant facts and circumstances, it is clear that the aspect of attribution was

too obvious and apparent for the Assessing Officer to have been ignored in the first round/original proceedings. In ***Usha International Ltd.*** (*Supra*), it is also noted that sometimes application of mind and formation of opinion can be ascertained and gathered even when no specific question or query in writing had been raised by the Assessing Officer. It is also observed that the aspects and questions examined during the course of assessment proceedings itself may indicate that the Assessing Officer must have applied his mind on the entry, claim or deduction, etc. In the present case, in the circumstances narrated above, it is evident that the when the Assessing Officer was examining the entire issue of royalty and its taxability the Assessing Officer must have examined Article 12 of the DTAA in its entirety, which also contained the exception mentioned in clause (6) thereof. We may also note that in ***CIT vs. Kelvinator of India Ltd*: [2002] 256 ITR 1 / 123 Taxman 433 (Delhi)** a full bench of this court held as under:-

> *"We also cannot accept the submission of Mr. Jolly to the effect that only because in the assessment order, detailed reasons have not been recorded an analysis of the materials on the record by itself may justify the Assessing Officer to initiate a proceedings under section 147 of the Act. The said submission is fallacious. An order of assessment can be passed either in terms of sub-section (1) of section 143 or sub-section (3) of section 143. When a regular order of assessment is passed in terms of the said sub-section (3) of section 143 a presumption can be raised that such an order has been passed on application of mind. It is well known that a presumption can also be raised to the effect that in terms of clause (e) of section 114 of the Indian Evidence Act judicial and official acts have been regularly performed. If it be held that an order*

which has been passed purportedly without application of mind would itself confer jurisdiction upon the Assessing Officer to reopen the proceeding without anything further, the same would amount to giving a premium to an authority exercising quasi-judicial function to take benefit of its own wrong."

13. It has been clearly observed that when a regular assessment is completed in terms of Section 143(3), a presumption can be raised that such an order has been passed upon a proper application of mind.

14. Therefore, in our view, what the Assessing Officer is now seeking to do amounts to a clear change of opinion and that is not permissible.

15. Apart from this the second point urged by the learned counsel for the petitioner/assessee has also to be accepted. The point was that the Revenue has been unable to point out as to which material fact had not been disclosed fully or truly. Even the reasons do not specify or indicate as to which material fact had not been disclosed fully or truly by the assessee.

16. In ***Swarovski India Pvt. Ltd. Vs. Deputy Commissioner of Income Tax*** **368 ITR 601 (Delhi)**, a division bench of this court observed that the escapement of income by itself is not sufficient for reopening the assessment

in a case covered by the proviso to section 147 of the said Act, unless and until there was failure on the part of the assessee to disclose fully and truly all the material facts necessary for assessment. It was also made clear that unless and until the recorded reasons specifically indicated as to which material fact or facts was/were not disclosed by the petitioner in the course of the original assessment under section 143(3), there could not be any reopening of assessment.

17. The decision of ***Swarovski India Pvt. Ltd.*** **(Supra)** has been followed in several other decisions including the decision in the case of ***Global Signal Cables (India) Pvt. Ltd. V. Deputy Commissioner of Income-Tax*** **(2014) 368 ITR 609 (Delhi)**. As already mentioned above, in the present case there is not even any allegation as to which material fact had not been disclosed fully or truly by the petitioner/assessee. To the contrary, the reasons recorded indicate that on the basis of very same facts which were before the Assessing Officer at the time of original assessment under Section 143(3), the reopening of the assessment has been proposed. No new material fact has been relied upon.

18. Thus, on both counts, the writ petition [WP(C) No. 12870/2009] pertaining to Assessment Year 2002-03 has to succeed. This very reasoning would also apply to assessment year 2003-04 [WP(C) No. 12856/2009]. As such, both the writ petitions are allowed. The impugned notices under

Section 148 of the said Act and all proceedings pursuant thereto including the orders disposing of the objections are quashed. There shall be no order as to costs.

BADAR DURREZ AHMED, J

SANJEEV SACHDEVA, J

OCTOBER 08, 2015
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