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

R5

\+ **ITA 13/2005**

DIRECTOR OF INCOME TAX ..... Appellant

Through: Mr. Rahul Chaudhary, Senior Standing Counsel.

versus

MITSUI & CO. LTD. ..... Respondent

Through: Mr. Mayank Nagi, Mr. Tarun Singh, Advocates.

R57

\+ **ITA 334/2005**

DIRECTOR OF INCOME TAX ..... Appellant

Through: Mr. Rahul Chaudhary, Senior Standing Counsel.

versus

MITSUI & CO. LTD. ..... Respondent

Through: Mr. Mayank Nagi, Mr. Tarun Singh, Advocates.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE PRATHIBA M. SINGH

O R D E R

% 27.07.2017

Dr. S. Muralidhar, J.:

1. Common questions of law arise for determination in these two appeals filed by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act').

Questions of law

2. ITA 13 of 2005 is directed against an order dated 31st March, 2004 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No. 5836/Del/1998 for the Assessment Year (AY) 1995-96. While admitting this appeal on 3rd February 2005, this Court framed the following questions of law for consideration:

> "1. Whether the Tribunal was right in holding that the Indian branches/offices of the assessee company and their activities cannot be regarded as permanent establishment of the assessee in India and income directly or indirectly attributable to these branches/offices is not taxable in India?
>
> 2. Whether the Tribunal was right in law in holding that the assessee company does not have any permanent establishment in India and its income from business turnover/imports in India was exempt in view of Agreement for Avoidance for Double Taxation between Indian and Japan?"

3. ITA 334 of 2005 is directed against an order dated 12th October, 2004 passed by the ITAT in ITA No. 4095/Del/1998 for AY 1994-95. While admitting this appeal on 10th May 2005, this Court framed the following question of law for consideration:

> "Whether the Income Tax Appellate Tribunal was correct in holding that the assessee company is not

having permanent establishment in India and therefore exempt under the provisions of the agreement for Avoidance of Double Taxation between India and Japan?"

Facts relevant to AY 1994-95

4. The facts relevant to AY 1994-95 are that the Respondent/Assessee is a non-resident company having its headquarters in Japan. The Assessee had two projects in India viz., the Anpara Thermal Power Project of the UPSEB ('Anpara Power Project') and the New Delhi Cable Project of DESU ('DESU Power Project'). In its return filed for the AY in question on 30th November, 1994 the Assessee declared a total income of Rs. 10,68,10,369. The Assessee disclosed an income of Rs. 6,57,28,814 from the Anpara Power Project and a loss of Rs. 1,28,57,065 from the DESU Power project. Subsequently, a revised return was filed by the Assessee on 25th May, 1995 declaring an income of Rs. 8,69,34,500.

The AO's order for AY 1994-95

5. The return was picked up for scrutiny and an assessment was framed at a total taxable income of Rs. 10,69,55,975 by the Assessing Officer (AO) order dated 25th March, 1997 under Section 143 (3) of the Act. The said total taxable income was arrived at by making an addition of Rs. 28,52,899 after concluding that the Assessee had a Permanent Establishment (PE) in India within the meaning of the Indo-Japanese Double Taxation Avoidance Agreement ('DTAA').

6. During the assessment proceedings, a questionnaire was issued to the

Assessee. An Authorized Representative (AR) of the Assessee appeared before the AO to provide the necessary details. The AO noted that the Assessee had a Liaison Office ('LO') in India which, according to the AO, helped the Assessee in finding new purchasers and sellers of goods and merchandise. The Assessee had contended before the AO that the conditions imposed upon it by the Reserve Bank of India ('RBI') permitting it to have an LO in India i.e. to not carry on any trading, commercial or industrial activity from such LO, was fully complied by it.

7. The Assessee maintained before the AO that the said LOs merely provided information to the overseas offices and, therefore, the Assessee had declared Nil income in respect of its liaison activity in India. The Assessee also contended that in AYs 1980-81 and 1981-82, the issue concerning the taxability of a liaison activity had been decided in favour of the Assessee by the ITAT holding that the LO could not be treated as PE in India within the meaning of the DTAA.

8. The AO noted that during the assessment proceedings, a Survey was undertaken on 14th May, 1997 on the Assessee's premises under Section 133 A of the Act. In the assessment proceedings, one Mr. M.P. Adhikari, Manager (Accounts) appeared and pointed out that each of the projects at the DESU and Anpara Power Projects had separate Project Offices (POs). The PO of the DESU Power Project was closed upon completion of the project. Mr Adhikari stated that the books of accounts of the DESU Power Project would be in the warehouse somewhere but the person concerned, viz., Mr. David would be able to give the details about them. He claimed

that he had no knowledge regarding the whereabouts of the books and stated that he would have to check with the concerned department of the Head Office that was in Tokyo. The books of accounts were, subsequently, produced by the Chartered Accountant (CA) appearing on behalf of the Assessee.

9. The Chief Representative of the Assessee in India, Mr. T. Ishibashi had a residential accommodation at 28A, Prithviraj Road, New Delhi. The AO noted that he looked after the entire operation of the LO at Le Meridien as well as the POs as and when the projects came up. Another factor which weighed with the AO to arrive at this conclusion was that the details of the telephone expenses of the DESU Power Project showed that some part thereof pertained to the LO. The AO concluded: "Therefore, it is very difficult to say that the liaison office is totally separated from the project operations, the imports and exports done by Mitsui & Co. etc."

10. As regards the decision of the ITAT for the earlier AYs, the AO noted that they did not involve income from the projects. The AO also noted that the Assessee had offered its income from the Anpara Power Project to tax under Section 44BBB of the Act by taking the profit at 10% of the entire value of the contract. However, the income of the DESU Cable Project had not been offered to tax on a similar basis. The explanation offered by the Assessee in this regard was not accepted by the AO. Interestingly, the Assessee contended that Article 7 of the DTAA would prevail over Section 44BBB of the Act. This was negated by the AO while recording that the Assessee should follow one method of taxing the income. Consequently, the

income from the DESU Power Project was also held to be taxable by the AO under Section 44BBB of the Act by taking the profit at 10% of the total turnover. Accordingly, Rs. 43, 11,511 was added to the Assessee's income and the loss of the DESU Power Project claimed as Rs. 1,28,57,065 was disallowed.

The CIT (A)'s order for 1994-95

11. The Assessee's appeal was partly allowed by the Commissioner of Income Tax (Appeal) ['CIT(A)'] by an order dated 29th May 1998. On the question of the LO being a PE, the CIT (A) held that:

(i) The Assessee had been acting in strict compliance with the conditions stipulated by RBI under Section 29 of the Foreign Exchange Regulation Act, 1973 (FERA). In AY 1981-82, this aspect had been examined in detail and a Special Bench of the ITAT had held in favour of the Assessee in its decision in ***Inspecting Assistant Commissioner v. Mitsui & Co. Ltd. [1991] 39 ITD 59 (Del) (SB).*** The Special Bench held that the LOs/Branches of the Assessee were merely concerned with liaison work. Therefore, the provisions of Section 9 (1) of the Act, as it then stood, would not apply to the Assessee and no part of its income from such LOs/Branches was assessable in India. This order was upheld by the CIT (A)for AY 1993-94.

(ii) In the survey under Section 133 A of the Act in the LO, no books of accounts relating to the projects of the company were found in the said premises. Further, although, Mr. Adhikari, Manager (Accounts) has mentioned that the books of accounts might be in the warehouse, the

maintenance of such a warehouse by the Assessee could not be proved by the AO. The fact that Mr. Ishibashi was looking after the LO as well as the PO did not in any way alter the position with regard to the maintenance of the LOs by the Assessee. "There was no rule in the Income Tax Law that one person could not supervise the LO work as well as the work of the PO"

(iii) No facts were marshalled by the AO in support of his conclusion that the LO was not totally separated from the POs. Considering that separate offices were maintained by the Assessee with regard to the project work and in view of the Article 5 (ii) of the DTAA, the AO had not been able to prove that the Assessee maintained either a place of management, branch office, factory, warehouse etc. Further, since the Assessee was showing the income from the project work separately, the question of treating the income from the project as that of the LO was not proper.

12. It should be noted here that the reference sought by the Revenue against the aforementioned decision of the Special Bench of the ITAT was returned unanswered by this Court by order dated 31st August, 2007 in ITR 326-327 of 1992 on the ground that the Revenue failed to file paper-books despite a lapse of 15 years. Likewise, as regards the orders for AY 1982-83, 1985-86, the reference was returned unanswered by this Court by order dated 10th March, 2007.

13. As regards the other issue regarding bringing to tax the profits of the DESU Power Project in terms of Section 44BBB of the Act, the CIT (A) observed:

> "On going through the assessment record I find that as per the letter dated 24.5.94 of DESU it was confirmed that the supply and erection of 220 KV XPLE Cable and accessories between I.P. Extension and Park Street Sub-Stns. was turn- key project. Subsequently though the DESU had issued another letter in this connection, the fact remains that the original letter did mention and the content of the project explaining this position that this project is a turn-key project. Moreover, the contention of the AR that the Exim Bank was funding the main Mitsui Company and was not directly funding does not make much difference in the situation because the appellant company is a part of the main company, which was receiving aid from the Exim Bank. Therefore, I agree with the AO, that the project was financed under an international aid programme. Even as the AR contended before me that the project was not approved as a 'Project' by the Department of Power, Ministry of Energy, Government of India; the fact remains that the project was approved by the Government of India; Ministry of Energy (Department of Power) on 25th March, 1991. So, all the conditions that are laid down u/s 44BBB are satisfied by the appellant company with regard to this project. So, the AO is perfectly justified in taxing the income from the power project u/s 44BBB and no interference is called for on this account."

The ITAT's order

14. Aggrieved by the above order, the Revenue went in appeal before the ITAT. By the impugned order dated 12th October, 2004, the ITAT dismissed the said appeal. The ITAT noted that only two grounds were raised by the Revenue, before it, which were that the CIT (A) erred in holding that:

> "1. That the Assessee company is not having a

permanent establishment in India and was, therefore, exempt under the provisions of agreement for avoidance of double taxation between India & Japan and

2. That the Assessee Company is not liable to tax u/s 9(1)(vi)(1) of the Income Tax Act, 1961 because it is not having any business connection in India."

15. By the impugned order dated 12th October 2004 ITAT held that both issues stood answered against the Revenue by its earlier order dated 4th June, 2002 in ITA 2939/Del/97 which pertained to AY 1993-94 and the order passed by the Special Bench reported in ***53 ITD 59***. A perusal of the impugned order reveals that the DR did not controvert the above position but supported the order of the AO.

Grounds in ITA 334 of 2005

16. In the appeal filed before this Court by the Revenue for the AY 1994-95 i.e. ITA 334/2005, the grounds that have been highlighted by Mr Rahul Chaudhary, learned Senior Standing counsel for the Revenue are:

"II. Because the Assessee had permanent establishment in India.

III. Because the Assessee is carrying on business through its branch offices.

IV. Because the provision of FERA and letter of RBI cannot be used as proof and evidence to determine and decide whether the Assessee had permanent establishment in India or not.

V. Because the term "permanent establishment' has

been given broad and wide definition in DTAA between India and Japan. It includes an office or a branch or a premises used for receiving or soliciting orders.

VI. Because the Assessee had admitted having business turnover, importing goods and selling them in India. This Income was taxable in India as Assessee had permanent establishment in India.

VII. Because the Ld. ITAT for the AYs 1978-79 and 1979-1980 has held that the Assessee had permanent establishment in India.

VIII. Because the Assessee had been functioning and carrying on business through its branch offices. It was incurring huge establishment expenses and carrying on trading activities.

IX. Because the Assessee had carried on business through a permanent establishment in India and profits directly or indirectly attributable to the permanent establishment were taxable in India.

XIX. Because the ITAT failed to appreciate the significance and importance of Article 5(4) of the DTAA that had been applied by the AO in the present case."

17. Interestingly, although in Ground II and elsewhere in the appeal, a reference is made to the "Branch Offices" of the Assessee, it was nobody's case, and definitely not for the AY in consideration, that the Assessee had any "Branch office" which was a PE.

The appeal concerning AY 1995-96

18. ITA 13 of 2005 is concerned with AY 1995-96. The basic facts are not different in this appeal. The Assessee filed its return of income for AY 1995-96 on 30th November, 1995 declaring a total income of Rs. 33,88,97,808. The Assessee had shown an income of Rs. 9,14,38,792 from the Anpara Power Project and a loss of Rs. 3,74,94,374 in respect of the DESU Power Project.

19. By the assessment order dated 23rd March, 1998 the AO held that the Assessee's LO constituted a PE in India and, accordingly, on proportionate basis, an income of Rs.54,57,627 was added to its taxable income in India. The AO basically followed the same approach as in the assessment order for AY 1994-95. The loss claimed for the DESU power project was disallowed and 10% of the turnover therefrom was added as income by invoking Section 44 BBB of the Act.

20. The CIT(A) by order dated 25th September, 1998 partly allowed the appeal filed by the Assessee following the order passed by the CIT(A) on 29th May, 1998 for AY 1994-95. The corresponding order dated 31st March 2004 of the ITAT upheld the order of the CIT (A). One question of law, as extracted hereinbefore, was framed by the Court for consideration.

Submissions of counsel for the Revenue

21. Mr. Rahul Chaudhary, learned Senior Standing counsel for the Revenue, took the Court through the provisions of the first DTAA between India and Japan which was entered into on 5th January, 1960 and pointed out the distinction in the definition of PE contained therein when compared to

subsequent DTAA entered into between the two countries on 1st March, 1990 and as amended from time to time.

22. Mr. Chaudhary advanced two lines of argument. The first was that the LO of the Assessee constituted a PE. He attempted an alternate submission that even assuming that the LO was not a PE, then the POs of the Assessee should be treated as PE themselves and, therefore the income of the Assessee was taxable under Section 9 of the Act.

23. Mr. Chaudhary reiterated the reasons that weighed with the AO in holding that the LO should be considered to be PE. First, the books of accounts of the POs were found in the warehouse of the Assessee. Secondly, Mr. Ishibashi was managing both the LO as well as the POs and thirdly, an analysis of the telephone expenses of the POs showed that some part thereof pertained to the LO. Mr Chaudhary also laid emphasis on the fact that under Article 5(6) (e), it is only where the maintenance of such LO is solely for the purposes of an activity of preparatory or auxiliary character, it would exempt it from being considered as PE. According to him, since the Assessee has been carrying on business in India for several years, and has executed several projects, no longer can the LO be considered to be only a place where the activity of preparatory or auxiliary character is carried out. He submitted that once, it was clear that there was a PE in India then there should be no difficulty in attributing the profits of the POs as well a percentage of the global income to such PE in terms of the Article 7 of DTAA, particularly, when Article 7 (1) permitted attribution of profits both 'directly' or 'indirectly' to the PE. This according to him was different from

similar clauses in other DTAAs.

Submissions of learned counsel for the Assessee

24. Mr. Mayank Nagi, learned counsel for the Assessee, on the other hand placed reliance on the earlier decision of the Special Bench of the ITAT for the earlier AYs where these very issues were examined with reference to the specific clauses of the DTAA. He points out that order of the Special Bench has attained finality since the reference sought by the Revenue was returned unanswered by this Court. He also placed reliance on the decision of this Court in ***National Petroleum Company Construction v. Director of Income Tax (International Taxation) 2016 (383) ITR 648 (Del)*** where a similar clause in the DTAA between India and UAE was interpreted by this Court. Emphasis was placed on a collective reading of Articles 5 (1) and 5 (2) of the DTAA. Reliance was also placed by the order passed by the ITAT in ***D.C.I.T v. M/s Sofema SA*** (order dated 5th May, 2006 in ITA No. 3900/D/2002) which was affirmed by this Court by its order dated 18th December, 2006 in ITA No. 1764/2006. This was further affirmed by the Supreme Court by an order dated 26th August, 2008 in Civil Appeal 5260/2008 (***Director of Income Tax, New Delhi XVII v. Sofema SA, New Delhi***).

25. Mr. Nagi submitted that the factual foundation for determining that the LO of the Assessee was a PE was not laid by the Revenue in the present case. According to him the conclusion drawn by the AO was based purely on surmises and conjectures. He placed reliance on the decision in ***Minakshiammal v. Chandrasekaran (2005) 1 SCC 280*** which cited with

approval the observations in ***R. v. Hodge 168 ER 1136.*** He submitted that in view of the mandate of the RBI, there was no question of on any business or trade being carried on in the LO.

26. Mr Nagi submitted that the onus of showing existence of PE lay on the Revenue. *Inter alia,* reliance was placed on a decision ***Northern Network v. DIT 386 ITR 353 Del***. He pointed out that during 30 years of the Assessee's functioning, the RBI has not found the LO to have violated any of the conditions on which, the Assessee was permitted to run such LO. Mr Nagi pointed out that the Survey conducted by the Revenue was not relevant to AYs 1994-95 and 1995-96. Lastly, he pointed out that no ground that the impugned order of the CIT(A) or the ITAT suffered from perversity was urged by the Revenue in either appeal.

Alternative ground not permitted

27. As regards the alternative ground urged by the Revenue viz., that even assuming that the LO was not a PE, then the POs of the Assessee should be treated as PE themselves ,the Court finds not a single ground anywhere in the two appeals that reflect the above alternative argument. It does not appear to have been urged by the Revenue before the AO, or the CIT(A) or even before the ITAT. The Court declines to permit the Revenue at the stage of final arguments in these appeals to urge such a ground for the first time.

Provisions of the DTAA

28. Before beginning to discuss the central issue viz., whether the LO of the Assessee was during the AYs in question a PE, the provisions of the DTAA

require to be examined. Article 5 of the DTAA reads as under:

> "1. For the purposes of this Convention, 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) a place of management;
> (b) a branch;
> (c) an office;
> (d) a factory;
> (e) a workshop;
> (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
> (g) a warehouse in relation to a person providing storage facilities for other;
> (h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on;
> (i) a store or other sales outlet; and
> (j) an installation or structure used for the exploration of natural resources, but only if so used for a period of more than six months.
>
> 3. A building site or construction, installation or assembly project constitutes a permanent establishment only if it lasts for more than six months.
>
> 4. An enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it carries on supervisory activities in that Contracting State for more than six months in connection with a building site or construction, installation or assembly project which is being undertaken in that Contracting state.

> 5. Notwithstanding the provisions of paragraphs 3 and 4 an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in that contracting State for more than six months in connection with the exploration, exploitation or extraction of mineral oils in that Contracting State.
>
> 6. Notwithstanding the provisions of the preceding paragraphs of this article, the term 'permanent establishment' shall be deemed not to include:
>
> (a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
>
> (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
>
> (c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
>
> (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
>
> (e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character."

29. Article 7 (1) which relates to attribution of the profits reads as under:

> "7 (1) The profits of an enterprise of a Contracting State shall be taxable only in that Contracting 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 that other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment."

30. There have been protocols developed in relation to DTAA and one such protocol which seems to explain Article 7(1) reads as under:

> "6. With reference to paragraph 1 of article 7 of the Convention, it is understood that by using the term 'directly or indirectly attributable to the permanent establishment', profits arising from transactions in which the permanent establishment has been involved shall be regarded as attributable to the permanent establishment to the extent appropriate to the part played by the permanent establishment in those transactions. It is also understood that profits shall be regarded as attributable to the permanent establishment to the above-mentioned extent, even when the contract or order relating to the sale or provision of goods or services in question is made or placed directly with the overseas head office of the enterprise rather than with the permanent establishment."

The decision in **National Petroleum**

31.1 The Court next proceeds to examine the legal position as regards a PE and in that context discusses in some detail decision of this Court in ***National Petroleum Company Construction v. DIT*** *(supra)* where an identical Article 5 of the DTAA between India and UAE was interpreted by the Court. It may be noticed here that Articles 5 (1) and 5 (2) of the said DTAA is identical to Articles 5 (1) and 5 (2) of the DTAA between India and Japan.

31.2 Paras 15, 16, 17 and 20 of the said decision in ***National Petroleum Company Construction*** (*supra*) are relevant in the present appeals and read as under:

> "15. In order to determine whether an enterprise has a permanent establishment within the meaning of article 5 of the Double Taxation Avoidance Agreement, it would be necessary to consider the scheme of article 5. Paragraph (1) of article 5 provides an over arching general definition of the expression "permanent establishment" (PE). It defines a permanent establishment to mean a fixed place of business through which the business of an enterprise is wholly or partially carried on. It is clear from the aforesaid definition that the expression "permanent establishment" entails (a) a fixed place of business; and (b) business of the enterprise being carried on wholly or partially through the said fixed place of business. These two conditions must necessarily be satisfied for the existence of a permanent establishment. In addition, the word permanent in the term "permanent establishment" indicates that there should be some degree of permanency attached to the fixed place of business before the same can be construed as a permanent establishment of an enterprise. The word permanent does not imply for all times to come but merely indicates a place which is not temporary, interim, short-lived or transitory. *In Re.P.No. 24 of 1996 [1999] 237 ITR 798 (AAR)*, the Authority for Advance Ruling referred to Baker's "Double Taxation Conventions and International Tax Law, second edition", wherein the author had cited the decision in *Henriksen (Inspector of Taxes) V. Grafton Hotel Ltd. [1943] 11 ITR (E.C) 10 (CA)* and explained that the expression "permanent" is relative and not synonymous with "everlasting" ; the Authority for Advance Rulings ruled that it was

used only in "contradistinction to something fleeting, transitory, temporary or casual".

16. Paragraph (2) of article 5 of the Double Taxation Avoidance Agreement provides for an inclusive definition of the term "permanent establishment" and specifically lists out places of business that fall within the meaning of that expression. The use of the word "especially" underscores the intention of the authors of the treaty to remove any doubts that the places listed in sub-paragraphs (a) to (i) fall within the definition of the term "permanent establishment". Normally an inclusive definition is used to expand the width of the term sought to be defined, however, that does not appear to be the principal intent in drafting paragraph (2) of article 5 of the Double Taxation Avoidance Agreement. Read in the context of the other provisions of article 5, paragraph (2) clearly indicates that it has been used as an explanatory provision to specifically include the species of places of business that would constitute a permanent establishment of an enterprise. In this view, paragraph (1) and (2) of article 5 of the Double Taxation Avoidance Agreement complement each other. Thus, all classes of permanent establishments as specified in various sub-paragraphs of paragraph (2) of article 5 of the Double Taxation Avoidance Agreement would be construed as a permanent establishment subject to the essential conditions of paragraph (1) of article 5 being met. In so far as sub-paragraphs (h) and (i) of paragraph (2) of article 5 are concerned, the test of permanence as required under paragraph (1) of article 5 is substituted by a specified minimum period of nine months. Thus, places of business as specified under subparagraphs (h) and (i) of paragraph (2) of article 5, cannot be construed as a permanent establishment of an enterprise unless

they exist for a period of at least nine months.

17. Paragraph (3) of article 5 is an exclusionary clause and is intended to exclude certain places of business from the scope of the expression "permanent establishment" paragraph (3) begins with a non obstante clause. "Notwithstanding the preceding provisions of this article". Thus, the exclusions provided under paragraph (3) would override the provisions of paragraphs (1) and (2) of article 5 of the Double Taxation Avoidance Agreement. In other words, even if a place of business squarely falls within the definition of paragraph (1) of article 5 and is specifically listed in paragraph (2) of the said article, the same would, none the less, not be construed as a permanent establishment of an enterprise, if it falls within any of the exclusionary clauses contained in sub-paragraphs (a) to (e) of paragraph (3) of article 5 of the Double Taxation Avoidance Agreement.

20. It is clear from the plain language of paragraph (1) of article 5 as well as article 5(3)(e) of the Double Taxation Avoidance Agreement that the functions performed at an office maintained by an enterprise would be vital to determine whether the office could be construed to be the permanent establishment of that enterprise for the purposes of the double taxation avoidance agreement. First of all, the business of an enterprise must be carried on, wholly or partially through the office in question ; secondly, the business activity carried on must not be that of a preparatory or auxiliary character . The question, thus, arises is whether the activities carried out by the Assessee through its project office at Mumbai are that of a preparatory or auxiliary character. This is the bone of contention between the Revenue and the Assessee.

Analysis and reasons

32. In the present case, the onus was on the Revenue to demonstrate that LO of the Assessee was a PE within the meaning of Articles 5 (1) and 5 (2) of the DTAA. In other words, it was not enough for the Revenue to show that the Assessee had an office, factory or a workshop etc. within the meaning of Article 5 (2) of DTAA. For the purpose of Article 5 (1), the Revenue was required to show that such place was "a fixed place of business through which the business of an enterprise is wholly or partly carried out."

33. For the AYs in question, the LO of the Assessee was not in fact used for the purpose of business. It is here that Article 5 (6) of the DTAA assumes significance. The use of facility solely for the purpose of search or display or for the maintenance of place for business solely for the purchases of goods or collecting information or for any other activity "preparatory or auxiliary in character" would take it outside the ambit of a PE.

34. Viewed in this context, the mere fact that the Manager of the Assessee stated that the books of accounts might be kept in a warehouse (which was unable to be shown by the Revenue to exist) or that some portion of the telephone expenses were attributable to the LO or that Mr. Ishibashi was managing both the LO as well as the PO was hardly sufficient to conclude the LO was being used to carry on the business of the enterprises. The CIT (A) found that the POs were treated as separate taxable units. In fact the profits therefrom were brought to tax by invoking Section 44 BBB of the Act. After having treated the POs as separate taxable units and having

offered the profits therefrom to tax under Section 44 BBB, the said POs cannot also be treated as PEs for the purpose of the DTAA.

35. The Court finds merit in the contention of counsel for the Assessee that the factual findings of the CIT (A) which has been conferred by the ITAT have not shown to be perverse by the Revenue. There is a categorical finding of the CIT (A) that two POs in question were treated as separately taxable units. CIT (A) correctly concluded that the AO was unable to prove that the Assessee had maintained a PE answering the description on a collective reading of Articles 5 (1) and 5 (2) of the DTAA.

36. On the issue of activity of 'preparatory or auxiliary character' it was noted by this Court in its decision in ***National Petroleum Company Construction v. DIT*** *(supra)* as under:

> ".....Whereas a liaison office can act as a channel of communication between the principal place of business and the entities in India and cannot undertake any commercial trading or industrial activity; a project office can play a much wider role. Regulation (6)(ii) of the aforesaid regulations mandates that a "project office" shall not undertake or carry on any other activity other than the "activity relating and incidental to execution of the project". Thus, a project office can undertake all activities that relate to the execution of the project and its function is not limited only to act as a channel of communication."

37. Indeed, the basic factual foundation for holding a LO of the Assessee as its PE has not been laid by the Revenue in the present case. The fact that the

Assessee was adhering to the conditions imposed by the RBI for running a LO, and the RBI had accepted the functioning of the Assessee's LO for over three decades, points out to the fact that the Assessee has complied to the conditions, one of which was that it could not carry on any business or trading activity in the LO. While, it is a moot question whether this would be binding on the Revenue, it certainly increases the burden of the Revenue to show that notwithstanding the RBI permission continuing during the AYs in question, the Assessee's LO should be construed to be a PE in terms of Articles 5 (1) and 5 (2) of the DTAA.

38. The Court has undertaken the exercise of again examining the factual position since in the impugned order the ITAT has merely relied upon its order for an earlier AY. While the Court appreciates the contention put forth by the Revenue that the facts of each AY has to be separately considered, the Court finds that there is no ground made out to disturb the reasoned order of the CIT (A) for both the AYs.

Conclusion

39. The only question framed in ITA 334 of 2005 for AY 1994-95 by order dated 10th May 2005 is answered in the affirmative i.e. in favour of the Assessee and against the Revenue. It is held that the ITAT was correct in holding that the Assessee did not have a PE in India and was therefore exempt under the provisions of the DTAA between India and Japan.

40. The questions framed by the Court by order dated 3rd February 2005 in ITA No. 13 of 2005 for AY 1995-96 are answered thus:

(i) Question (1) is answered in the affirmative i.e. in favour of the Assessee and against the Revenue. It is held that the ITAT was right in holding that the offices of the Assessee and its activities during the AY in question could not be regarded as its PE in India and the income directly or indirectly attributable to the said offices was not taxable in India.

(ii) Question (2) is answered in the affirmative i.e. in favour of the Assessee and against the Revenue. It is held that the ITAT was right in law in holding that the Assessee does not have any PE in India and its income from business turnover/imports in India was exempt in view of DTAA between India and Japan.

41. The appeals are, accordingly, dismissed but in the circumstances, with no orders as to costs.

S. MURALIDHAR, J.

PRATHIBA M. SINGH, J.

JULY 27, 2017
j/srb