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

10-14.

\+ **ITA 714/2014**

COMMISSIONER OF INCOME TAX-III ..... Appellant

Through: Ms Suruchi Aggarwal, Senior Standing Counsel, Mr Abhishek Sharma, Ms Radhika Gupta, Mr Rajesh Kumar and Ms Lakshmi Gurung, Advocates.

versus

M/S SUMITOMO CORPORATION ..... Respondent

Through: Mr. C.S. Aggarwal, Senior Advocate with Mr. Prakash Kumar, Advocate.

With

\+ **ITA 716/2014**

COMMISSIONER OF INCOME TAX-III ..... Appellant

Through: Ms Suruchi Aggarwal, Senior Standing Counsel, Mr Abhishek Sharma, Ms Radhika Gupta, Mr Rajesh Kumar and Ms Lakshmi Gurung, Advocates.

versus

M/S SUMITOMO CORPORATION ..... Respondent

Through: Mr. C.S. Aggarwal, Senior Advocate with Mr. Prakash Kumar, Advocate.

With

\+ **ITA 717/2014**

COMMISSIONER OF INCOME TAX-III ..... Appellant

Through: Ms Suruchi Aggarwal, Senior Standing Counsel, Mr Abhishek Sharma, Ms Radhika Gupta, Mr Rajesh Kumar and Ms Lakshmi Gurung, Advocates.

versus

M/S SUMITOMO CORPORATION ..... Respondent
Through: Mr. C.S. Aggarwal, Senior Advocate with Mr. Prakash Kumar, Advocate.

With

\+ **ITA 719/2014**

COMMISSIONER OF INCOME TAX-III ..... Appellant

Through: Ms Suruchi Aggarwal, Senior Standing Counsel, Mr Abhishek Sharma, Ms Radhika Gupta, Mr Rajesh Kumar and Ms Lakshmi Gurung, Advocates.

versus

M/S SUMITOMO CORPORATION ..... Respondent
Through: Mr. C.S. Aggarwal, Senior Advocate with Mr. Prakash Kumar, Advocate.

And

\+ **ITA 789/2014**

COMMISSIONER OF INCOME TAX-III ..... Appellant

Through: Ms Suruchi Aggarwal, Senior Standing Counsel, Mr Abhishek Sharma, Ms Radhika Gupta, Mr Rajesh Kumar and Ms Lakshmi Gurung, Advocates.

versus

M/S SUMITOMO CORPORATION ..... Respondent
Through: Mr. C.S. Aggarwal, Senior Advocate
with Mr. Prakash Kumar, Advocate.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE VIBHU BAKHRU

O R D E R

% 16.11.2015

1. These appeals by the Revenue are directed against a common order dated 27th February 2014 passed by the Income Tax Appellate Tribunal ('ÍTAT') in ITA Nos. 3943, 3944 & 3945/Del/1999 relating to the Assessment Years ('AY') 1992-93, 1993-94, 1996-97, and, ITA Nos. 5882 and 5883/Del/1998, relating to the AYs 1994-95 and 1995-96.

2. By order dated 19th May 2015, while admitting these appeals, the following question of law was framed for consideration:

> Did the ITAT fall into error in holding that the fee for technical services received by the assessee from M/s. Maruti Udyog Limited was not taxable by reason of Article 12(2) of the Double Taxation Avoidance Agreement?

3. The Respondent Assessee is a company incorporated in Japan and is being assessed to tax in Japan. The Assessee supplies equipments from Japan on the basis of the global tenders floated by Maruti Udyog Ltd. ('MUL'). The supplies were made against separate and independent purchase orders ('POs') issued by MUL. Separate POs were also raised for "supervision and installation". According to the Assessee, neither the

monies received for the supplies, nor the supervision fee is taxable in India as supervision fee is integral to the provision of supplies. However, the Assessee accepted the Revenue's contention that the supervision fee is taxable in India as fee for technical services (FTS) in terms of Article 12(5) of Double Taxation Avoidance Agreement ('DTAA') between India and Japan.

4. In the assessment orders dated 27th March 1997 and 23rd March 1998 for the AYs 1994-95 and 1995-96 respectively, the Assessing Officer ('AO') held that the FTS was taxable as business income under Article 7 read with Article 12(5) of the DTAA.

5. At this stage, it requires to be noted that it is the case of the Assessee that it had no permanent establishment ('PE') in India as far as offshore supplies made of equipment and spares was concerned. Pursuant to the approval granted by the Reserve Bank of India ('RBI'), the Assessee has been having a liaison office ('LO') in New Delhi since 1956. It has sub-LOs in Mumbai, Chennai, Bangalore and Calcutta. After the introduction of the Foreign Exchange Regulation Act, 1973 ('FERA'), the LO was granted an extension of licence by a letter dated 17th February 1976. It was permitted to carrying liaison activities subject to the following conditions:

> "(i) The entire expense of the LO will be met exclusively out of the remittances received from abroad;
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> (ii) no commission/fee will be charged or any other remuneration received for the liaison activities to be rendered by the Indian offices;
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> (iii) Excepting the said liaison work, the Indian offices will not

undertake any activity of a trading, commercial or industrial nature without the prior permission of the RBI."

6. Even prior to the execution of the DTAA between the India and Japan in 1989, an issue had arisen as to whether the profits earned by the Assessee on the equipments sold by it from Japan on a principal–to-principal basis, free on board ('FOB') foreign port to an Indian buyer, was chargeable to tax under the Act. The Assessee had filed a writ petition against the Income Tax Department ('Department') in late 1970. Pursuant thereto, a compromise was arrived at, the terms of which were crystallized in a letter dated 19th March 1980 of the Department. The terms provided that the Assessee's LO in India would pay tax on the profits in respect of all imports into India, applying the following formula:

> "One third (33 1/3 per cent) of the profits arising out of the imports from Japan to India worked out on the basis of the turnover in India, multiplied by the net profit rate of the world income."

7. It is not in dispute that in terms of the above formula, the Assessee has been paying taxes on its earnings arising out of the imports to India. At that stage, the concept of PE was not in vogue. The DTAA between India and Japan came into force from 29th November 1989. Article 12 of the DTAA, the relevant portions of which pertains to payment of royalties and fees for technical services, reads as under:

> **Article 12**
> 1.Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other contracting State may be taxed in that other Contracting State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that Contracting Stage, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 20% of the gross amount of the royalties or fees for technical services.

3. The term "royalties""as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films and films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

4. The term "fees for technical services" as used in this Article means payment of any amount to any person other than payments to an employee of a person making payments and to any individual for independent personal services referred to in Article 14, in consideration for the services of a managerial, technical or consultancy nature, including the provisions of services of technical or other personnel.

5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting Stage, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other Contracting Stage independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply."

8. In terms of Article 7(1), unless the enterprise (i.e. the Assessee) of a contracting state (i.e. Japan), carries on the business in 'other contracting stage' (i.e., India) through a PE situated in India, the profits of the Assessee would be taxable only in Japan. Where the Assessee has a PE in India the profits "as is directly or indirectly" attributable to the PE will be taxed in India.

9. Article 5 of the DTAA defines a PE. Under Article 5 (1) a PE means "a fixed place of business through which the business of an enterprise is wholly or partly carried on." Article 5(2) to 6) which is relevant for the present purposes reads as under:

> "2. The term "permanent establishment" includes especially:
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> (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 others;
> (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 Stage 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 proceeding 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".

10. The case of the Assessee has been that, as far as the supplies of equipment are concerned, it has no PE in India. The LO of the Assessee in India was communicating information regarding publication of global tenders invited by MUL to the head office. The bid would be submitted only by the head office in Japan. The head office through its personnel from

Japan would visit India and after discussion with MUL would conclude contracts for the supply of equipments. The Assessee's head office secured 10 contracts for the supply of equipments during AY 1994-95, 25 contracts in AY 1995-96, five contracts in AY 1992-93, 1 contract in AY 1993-94 and four contracts in AY 1996-97. Under some of the contracts, the Assessee was only to supply equipments and in some other contracts, it was also to supervise the installation of the equipments. In some of the contracts, the MUL carried out the actual installation while the Assessee supervised such installation.

11. Another factor that requires to be noticed is that during this very period, the Assessee started expanding its activities in India and established project offices for the following three separate projects:

(i) A project at Raichur with the Karnataka Power Corporation

(ii) A project at Basin in Tamil Nadu.

(iii) A paint and assembly shop for MUL.

12. The last mentioned project office was established with the approval of the RBI dated 15th September 1992 granted under Section 29(1) (a) of the FERA. This was for the purposes of designing, engineering, supply and installation of the YE2 car project, whereunder there would be expansion of the car production between 70,000 to 90,000 cars per year.

13. For AY 1994-95, the Assessee filed its return of income disclosing an income of Rs.3,49,82,616. The Assessee received FTS for supervision of the installation of the machinery and equipments supplied by it to MUL in the sum of Rs.2,35,86,939. By a letter dated 18th July 1996, the AO called upon the Assessee to explain as to why the said sum received as FTS should not be offered to tax by the Assessee. By a reply dated 5th August 1996, the Assessee informed the AO that MUL had deducted tax at source on the FTS paid to the Assessee at 30.25 %. Accordingly, the Assessee was under the impression that the fee which was already subjected to TDS need not be shown or declared in the return of income. The Assessee nevertheless assured that it would declare hereafter such income in its return of income.

14. By a letter dated 19th August 1996, the Assessee listed all the ten POs obtained in the AY under consideration, in terms of which it supplied machinery and equipments and also undertook supervision and installation of the plant and machinery. The Assessee contended that each contract for supply and supervision of installation was independent and separate. The technical aspects of the work involved in each of the contracts were different and varied. In other words, notwithstanding that the contracts were with MUL, the period for which the supervisory activities were carried out was less than 180 days for each contract. It was contended that there was no PE of the Assessee in India *vis-a-vis* the rendering of the supervisory services to MUL.

15. The Assessee contended that for the projects being executed by it with Karnataka Power Corporation td. (Raichur Project) and with Tamil Nadu

Electricity Board (Basin Bridge Project) there were PEs. It was pointed out that the income from the said projects was being taxed under Section 44BBB of the Act. It was stated that the contract with MUL was in no manner connected with the projects at Raichur and Basin Bridge. The contention of the Assessee was that the tax on the fee received had to be taxed at 20 % in terms of Article 12(2) of the Indo Japan DTAA and not at 30.25% under Article 12 (5) of the DTAA.

16. The AO held against the Assessee and the Commissioner of Income Tax [CIT (A)] affirmed the said additions made by the AO. Penalty proceedings was also initiated for AYs 1992-93 and 1993-94 holding the FTS as business income under Article 7 read with Article 12(5) of the DTAA. The Assessee preferred an appeal before the ITAT.

17. Before the ITAT, at the instance of the Assessee, an additional ground was framed on 15th July 2003 as under:

> "Whether on the facts and in the circumstances of the case in law, the supervision fees earned on account of the supply of equipment could be taxed as 'Tees for technical services", even though they are integral and incidental to the supply of equipment, since the supervision fees received by it on account of the supply of equipment are inextricably and essentially linked to the supply of equipment, and hence, should in all fairness partake the same character as the supply of the equipment as it is nothing else but a supply of equipment simpliciter".

18. By order dated 31st May 2007, the ITAT held that the supervision fee is taxable under Article 12(2) since the Assessee did not have a PE and the

supervisory activities in respect of the installation of the equipments were not "effectively connected" to PE in India in terms of Article 12(5) of the DTAA. As regards the additional ground permitted by the ITAT to be urged by order dated 15th July 2003, the ITAT held that necessary facts were not available on record in order to establish whether the supervision activities were inextricably linked to the supply of equipment and should be treated in the same manner as the supply of the equipments itself. Thus the additional ground was not disposed of. The Revenue filed an appeal before this Court on the question whether the supervision fee is taxable under Article 12(2) or under Article 7 read with Article 12(5) of DTAA. The Assessee filed a cross-appeal on the question whether the ITAT ought to have decided the additional ground raised by it.

19. While hearing both sets of appeals together, this Court by order dated 6th April 2009 held that the ITAT ought to have decided the additional ground and accordingly remanded the matter to the ITAT for that purpose. While disposing of both sets of appeals, this Court formulated the question to be decided by ITAT as under:

> "Whether in the facts and circumstances of the case "fees for technical services" (FTS) received by the Assessee from Maruti Udyog Limited was taxable under Articles 12(2) or 12(5) read with Article 7(3) of the Indo-Japan Double Taxation Avoidance Agreement."

20. On remand, the ITAT held by the order dated 27st February 2014 that the Assessee had no PE in India and that the supervisory services were not

connected through any of its other PE in India and that since the supervision fee was earned in India it is taxable under Article 12(2) of DTAA at 20%.

21. Against the aforementioned order of the ITAT, the present appeals have been filed by the Revenue.

22. The Court has heard the submissions of Ms. Suruchi Aggarwal, learned Senior Standing counsel for the Revenue and Mr. C.S. Aggarwal, learned Senior counsel for the Assessee.

23. It was first submitted by Ms. Suruchi Aggarwal that the concurrent findings of both the AO and the CIT (A) were that the Assessee had its PE in India. It was admitted by the Assessee during the course of assessment proceedings that there were multiple contracts all related to MUL. The Assessee's office in India agreed to the deduction of TDS at 30.25% which in fact would locate the transaction within Article 12(5) read with Article 7(3) of the DTAA. It was further submitted that a perusal of the POs placed by the MUL on the Assessee, which have been set out in a tabular form in the earlier order dated 31st May 2007 passed by the ITAT, would show that the specification of days of supervision was essentially the basis for calculation of supervision fees which was one of the components of the order. The other component was the supply of the equipments itself. Some of the orders, having the value of Rs. 100-200 crores, involved man days of 478, 364 and 730. While the ITAT answered the question for the AY 1995-96, it remanded the matter to the AO on the ground that the facts on record were not sufficient to come to a definite conclusion. It was further submitted

that the supervision fees were related to the YE2 car project which was a separate project for which the Assessee had a project office. The LOs were not merely collecting information or carrying on an activity of a preparatory or auxiliary nature but were actively associated with the said project. The fact that the LO had written to MUL regarding TDS in respect of the contracts also showed the nature of its involvement in the projects. Therefore, the LO was in fact its PE. Finally, it was submitted that there was no requirement in terms of Article 5 (4) of the DTAA that the PE should carry on the supervisory activities for six 'continuous' months. It was enough if the aggregate period for which the supervision took place was six months or more.

24. In reply, Mr. C.S. Aggarwal, learned Senior counsel for the Assessee, referred to the earlier findings rendered in the order dated 31st May 2007 of the ITAT which according to him bore the reiteration by the ITAT in the present impugned order. He referred to the difference in the wording of the DTAA between India and Japan as compared with the corresponding clauses of the DTAAs with other countries, which showed that where it was intended that the computation of the six months period for the purposes of determining whether there was a PE had to be in the aggregate and not continuous the relevant clause in the DTAA expressly stated so. He also submitted that the theory of 'force of attraction' would not apply. In other words, there were separate POs relating to other projects undertaken by the Assessee and there could be no presumption that the LOs were 'effectively connected' with the said project offices. He supported the impugned order of the ITAT and submitted that the FTS in the present case was taxable under

Article 12(2) at 20%. As regards the alleged admission by the Assessee that there it could be taxed at 30.25%, Mr. Aggarwal pointed out that apart from the fact that the Assessee had retracted such admission, MUL had a legal obligation, without reference to the Assessee, to deduct TDS from the FTS paid. This by no means precluded the Assessee from challenging the applicability of the rate of TDS at 30.25%.

25. As far as the question framed by this Court is concerned, the issue that arises is whether the TDS from the FTS paid by MUL to the Assessee should be 20% in terms of Article 12(2) or 12(5) read with Article 7 of the DTAA? This in turn raises the question of whether, for the activity of supply of equipments by the Assessee to MUL, with or without supervision of the installation, it could be said that the Assessee had a PE in India?

26. Under Article 7 of the DTAA, the Assessee would be liable to pay taxes in India if it carried on the business through a PE. The part played by the PE in the transactions in question would determine the extent to which the profits from such transactions can be attributed to the PE. Article 5 of the DTAA is relevant for determining whether the Assessee could be said to have a PE in India.

27. Article 12(5) of the DTAA is on the lines of the OECD Model Convention. It is noticed that the clause in the OECD Model Convention allows the State, where the PE is located, to "to tax only those profits which are economically attributable to the PE." The clause makes a distinction between those incomes which are the result of activities of the PE and the

income that arises by reason of direct dealings by the enterprise from the head office without the aid or assistance of the PE. Thus, Article 12(5) adopts the "no force of attraction principle". The rationale behind the said rule was to avoid restricting entrepreneurial freedom of disposition "through fictitiously allocating profits by way of generalizing standards". Another principle is that the "material date for determination of accrual of income arising through the PE is the existence of the PE at the time when whatever decisively caused the profits to accrue, actually occurred." The income producing activities should be connected with the PE not only economically but also in substance.

28. It was in the above background that the ITAT examined each of the POs for the various AYs in a tabular form. On examination of the POs, a common feature which emerged was that the supervisors were to come from Japan and MUL had to bear the cost of their air tickets as well as their boarding and lodging in India. The period of supervision in the case of the individual contracts did not exceed the period of 180 days. In other words, they did not constitute a supervisory PE in terms of Article 5(4) of the DTAA.

29. As far as the FTS paid to the Assessee for the supervisory services is concerned, there was no effective connection between the execution of the POs for supply of equipment and supervision of their installation, and, the project office for the paint and assembly shop of the YE2 car project of MUL. Additionally, as pointed out by Mr. Aggarwal, the supervisory fee paid by MUL was on the basis of "man days". The number of days per

supervisor was calculated by dividing 'man days' by the 'number of supervisors'. If 10 supervisors had stayed for 100 man days, the supervision period would be 10 days only, though the 'man days' are 100. Thus, the period of stay would be only of 10 days and not 100 days.

30. As regards the contention that the Assessee had conceded the position that MUL could deduct tax at 30.25%, it is seen that the LO only facilitated the communication between the head office and MUL. The explanation that its letter on the rate of TDS was given only to expedite the payment from MUL, appears plausible. The Assessee offered the FTS to tax at 20% and claimed refund. The Court is unable to view the aforementioned communication of the Assessee to MUL as an estoppel against the Assessee from claiming to be taxed in accordance with law.

31. A comparison of the relevant portions of Article 5 of the DTAA between the India and Japan with the corresponding clause in some of the DTAAs entered into by India with other countries shows that where it is intended that the computation of the period of the six months period for determining whether an Assessee can be said to have a PE should be in the aggregate, i.e. not 'continuous', the DTAA itself provides for it. From the wording of the Article 5 of the DTAA in question, it is not possible to accept the plea of the Revenue that the supervisory activities need not have been carried on for six continuous months.

32. For the aforesaid reasons, the Court concurs with the views of the ITAT that in the present case the FTS was liable to be taxed at 20% under Article

12(2) of the DTAA. The question is accordingly answered in the negative, i.e. in favour of the Assessee and against the Revenue.

33. The appeals are accordingly dismissed.

S.MURALIDHAR, J

VIBHU BAKHRU, J

NOVEMBER 16, 2015
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