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content is, prima facie, software, eligible for depreciation at 60 per cent. as claimed.

7. The Commissioner of Income-tax (Appeals) erred in not noting that intangible assets have been specifically defined under Part D of the Appendix to the Income-tax Rules as being know-how, patent, copyright, trade mark, licence or commercial rights of similar nature. On the other hand, Appendix I to the Income-tax Rules clarifies in Note 7 thereof that information technology software is eligible for depreciation at 60 per cent. There is thus no scope or justification in confusing tangible and intangible assets that have been demarcated clearly.

8. The Commissioner of Income-tax (Appeals) erred in relying upon various judgments of foreign courts to conclude that software is an intangible asset. He ought to have followed the law laid down by the Supreme Court in the case of *Tata Consultancy Services* v. *State of Andhra Pradesh* to the effect that computer software is a tangible asset. The Commissioner of Income-tax (Appeals) is bound in terms of article 141 to follow the law laid down by the Indian Supreme Court rather than the judgments of the foreign courts that has come to a different conclusion. Likewise, the Commissioner of Income-tax (Appeals) prefers to rely upon the classification of software as intangible asset by the Institute of Chartered Accountants of India ignoring the judgment of the Supreme Court cited (supra). The judgment of the Supreme Court in the appellant's own case also supports the case of the appellant and has been distinguished for wholly unacceptable reasons.

Disallowance under section 14A of the Income-tax Act

9. The Commissioner of Income-tax (Appeals) erred in confirming the disallowance of an amount of Rs. 57,49,365 in terms of section 14A read with rule 8D of the Income-tax Rules.

10. The Commissioner of Income-tax (Appeals) ought to have noted that the provisions of section 14A would apply only in respect of exempt income in relation to which expenditure has been incurred and not to the present case where no expenditure has been incurred at all.

11. The Commissioner of Income-tax (Appeals) ought to have noted, the investments themselves have been occasioned pursuant to an order of the High Court sanctioning a scheme of merger. Hence, the disallowance of notional expenditure has no basis and is liable to be cancelled in full.

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Interest

12. The Commissioner of Income-tax (Appeals) erred in confirming levying interest under sections 234B and 234D of the Act. The levies are arbitrary, high and liable to be cancelled.

13. Any other ground that may be raised at the time of personal hearing."

3 First we will take up the appeal filed by the assessee for the assessment year 2007-08 in I. T. A. No. 1406/Chennai/2015. The only limited issue in the appeal filed by the assessee for the assessment year 2007-08 to be adjudicated by us is as to the rate of depreciation allowable to the assessee on "digital content", i. e., whether the assessee is entitled for depreciation at the rate of 25 per cent. or 60 per cent. This is the second round of litigation before the Tribunal and in the first round of litigation before the Tribunal, the Revenue had filed an appeal with the Tribunal and the Tribunal was pleased to set aside the matter back to the file of the Assessing Officer in I. T. A. No. 144/Mds/2011, vide order dated September 9, 2011 for readjudication of the issue by the Assessing Officer afresh after considering the contentions of the assessee, provision of law, case law, etc., by passing a speaking order. In the second round of litigation, the Assessing Officer vide assessment order dated March 31, 2013 passed under section 143(3) read with section 254 of the 1961 Act held that the assessee is entitled for depreciation at 25 per cent. on "digital content" developed by it as the same is "intangible asset" and the assessee is not entitled for depreciation at 60 per cent. as the said digital content is not computer software. The assessee on its part had contended before the Assessing Officer in the second round of litigation that the assessee is an animation and special effects company using computer as camera and it has produced eight animation films and visual/special effects for more than 500 Indian and International films. The assessee submitted that these animation of special effects are produced using computer software and specially prepared software for the characters, backgrounds and properties which are made specially and then combined using many computers processers to make shots. These are called "digital content" which is available in hard disk/drive of the computer. The assessee submitted that the assessee is an 100 per cent. EOU status under the EHTP scheme and is engaged in development of "digital content"/ "animation software" for utilisation in the production of films. The assessee submitted that these are customised softwares and depreciation claimed for software is 60 per cent. as per the Income-tax Act, 1961. Further, the assessee submitted that the assessee has claimed depreciation on the "digital content" and animation software developed by it and utilised

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for the purpose of production of films. The assessee submitted that it engages software programmers who write necessary code for the software which is later translated into machine readable form resulting in software that is stored in an information storage device like hard disk. The software relates to various visual effects that are utilised for making of films and it was submitted that this animation software constitutes stock-in-trade of the assessee which is exploited by it in production of business of animation films. The assessee relied upon *Explanation 2* to section 10B of the Act, which defined computer software as under :

"10B. . . .

Explanation 2.—For the purposes of this section—

(i) 'computer software' means—

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device ; or

(b) any customised electronic data or any product or service of similar nature as may be notified by the Board,

which is transmitted or exported from India to any place outside India by any means ;"

The assessee submitted that the animation software developed by it satisfies the definition of computer software, being a programme, recorded and stored in an information storage device and utilised in the business of the assessee. The assessee also referred to the judgment in the case of *Commissioner of Customs* v. *Pentamedia Graphics Ltd.* wherein the hon'ble Supreme Court concluded in the context of laws applicable to customs that the "motion capture animation films" would qualify to be classified as information technology software. Thus, the assessee submitted before the Assessing Officer that the digital content/animation software developed by it is of the nature of application software used by it in the business of movie production, eligible to depreciation at 60 per cent.

The assessee also submitted that as per the Accounting Standard 26, the intangible asset is identifiable as under :

"An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Non-monetary assets are assets other than monetary assets.

Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible

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resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trade marks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

Not all the items will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation.

Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under Accounting Standard 10, accounting for fixed assets, or as an intangible asset under this standard, judgment is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset."

It was submitted by the assessee before the Assessing Officer in the second round of litigation that the "digital content" "animation software" developed is in the nature of application software which is used by the

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assessee in the business of movie production and is eligible for depreciation at 60 per cent.

3.2 The Assessing Officer rejected the contentions of the assessee and held that the assessee is entitled for deprecation at 25 per cent. on "digital content" as the same is intangible asset and not computer software, by holding as under, vide assessment order dated March 31, 2013 passed under section 143(3) read with section 254 of the 1961 Act :

> "14.1 The issue is whether the 'digital content' acquired by the assessee is eligible depreciation at 60 per cent. as applicable for computer software or at 25 per cent. as applicable to intangible assets.
>
> 14.2. The issue considered by the hon'ble Supreme Court is whether the 'motion capture animation films' is computer software and is eligible for exemption from customs duty or not. The Supreme Court has held that the same are computer software after verifying the contents and with relevance to the Customs Act. The Customs Act deals with the goods at the point of entry and the subsequent state of the goods is not relevant to the grant of exemption under the Act. Further, the issue herein is whether the asset is a tangible asset or intangible asset under the Income-tax Act. As the decision of the Supreme Court is on a different context and the Supreme Court has not examined with relevance to the Income-tax Act relying on the same by the assessee/is not correct.
>
> 14.3 The assessee-company has given certain clips which show the manner in which the animation is produced. It shows first a drawing of caricatures for a particular scene and converting the same to an animation film. It appears that the assessee has misunderstood the query raised in the letter dated March 13, 2013. The purpose of the query was to see how the assessee-company is using the animation in its business. The software which it acquires from outside and uses for its own business as application software without altering the same would be eligible as computer software. The same is like Ms-Office, etc. But, as stated by the assessee-company itself the digital content which is developed in-house is used in the business of movie production.
>
> 14.4 From the submissions of the assessee, it is clear that it has utilised the software in the production of films but the same was developed by it as digital content/ animation software and still owned by it.
>
> 14.5 Let us now deal with the difference between the software developed/acquired and copy of computer software purchased by it.

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In the case of the first one, the company holds the rights of the said software and sells or gives a copy of the same to its clients, which are separately considered in the trading account. However, the issue is how the same is to be treated in the hands of the assessee-company. It is undoubtedly its intellectual property right having enduring benefit, as claimed by itself that it is eligible to use the animation in sequels, etc. For example, the animation on characters like Ganesa, Buddha created by the company can be used again and again in various projects. Though these items are in the form of developed software they are intangible assets of the company in the first place. Therefore, it is clear that the software has longer and enduring life period, which has been demonstrated by the assessee's own submissions.

14.6 Further, it is to be clearly understood that it is not the case that the company has developed software for a client and sells to it. Here, only copy of software, which is not for a particular client, is sold or implemented for clients. The assessee still holds the rights of the software and also generates revenue. This is precisely the intellectual rights of the assessee. The Income-tax Rules clearly provide for depreciation at the rate of 25 per cent. on intangible/assets which includes intellectual property rights.

14.7 The fact that software has component of intellectual property rights is relevant from the provisions of section 72A, which is discussed hereunder :

'A restriction was placed under section 72A on set off of losses for an amalgamated company on amalgamation or a resultant company on demerger in respect of an industrial undertaking. Computer software, telecommunication services, electricity are specifically included in the definition of "industrial undertaking". This specific inclusion provided in the case of software, electricity or in the matter of provision of certain telecommunication services is not for the reason that they are not industrial undertaking but since intellectual property rights are involved in them to avoid any ambiguity.'

14.8 Therefore, the computer software which have been developed or acquired on acquisition as that of its own, are to be considered only as intangible assets and allowed depreciation at 25 per cent.

14.9 The assessee-company has also drawn parallel with the software like Microsoft products, adobe, etc. Even this parallel goes against the contention of the assessee. It has been the universally accepted fact that the Microsoft holds intellectual property rights of

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its. Properties (software) and only issues copies of the same with the licence for its use and it continues to exploit its software with the rights owned by it. Similar is the case of software, like photoshop, etc., of Adobe.

14.10 It is to be noted herein that section 32 deals with an asset, whether it is tangible or intangible in the first place. The prescribed rates comes into play only once the asset is categorised as tangible or intangible. Animation software developed by the company is eligible for depreciation as applicable to intangible assets since the company holds intellectual property rights and exploits the same.

14.11 In view of the above, it is clear that the assessee-company is eligible to claim depreciation at 25 per cent. only on digital contents developed by it as the same is held as intangible assets."

The assessee being aggrieved by an assessment framed by the Assessing 4
Officer in the second round of litigation vide assessment order dated March 31, 2013 passed under section 143(3) read with section 254 of the 1961 Act filed first appeal before the learned Commissioner of Income-tax (Appeals). The learned Commissioner of Income-tax (Appeals) was pleased to dismiss the appeal filed by assessee, vide appellate order dated March 23, 2015 by holding as under :

"6. The decision

6.1 The appellant raised the following grounds :

'The assessing authority ought to have noted that the claim of the appellant of depreciation at the rate of 60 per cent. is in line with Appendix I to the Income-tax Rules that prescribes the said rate in relation to "computer software".

The assessing authority ought to have noted that the content developed by the appellant satisfies the definition of "computer software" as set out in the Appendix and the appellant is thus entitled to the rate of depreciation prescribed thereunder. The judgment of the Supreme Court in the context supports the stand of the appellant in this regard.'

The appellant relies on Appendix I to the Income-tax Rules where under computers, including computer software are entitled to depreciation at the rate of 60 per cent. 'Computer software' is defined in the Appendix to mean a computer programme recorded on any disc, tape, perforated media or other information storage device. It was claimed that the digital content developed by the appellant is essentially 'computer software' in so far as it related to the computer

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programme that has been recorded on a storage device such as a disc. Further, it was stated that the content developed utilised in the multimedia and entertainment industry and, by its very nature, is a series of software programmes recorded on storage devices.

6.2 Rule 5 permits the percentages specified in the second column of the Table in Appendix I (Income-tax Rules 1962), on the written down value of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year. Part A of the Appendix I deal with the rates for tangible assets. This table (III. Machinery and plant (5)) prescribes depreciation at 60 per cent. for computers including computer software. Computer software has not been defined in the Act. But in Note 7 to Appendix I to the Income-tax Rules, it has been explained to include computer programme recorded on any disk, tape, perforated media or other information storage device.

6.3 The first issue in the present case is whether the computer software is a tangible or intangible asset and whether the assessees get ownership right by acquiring/developing the same. In several cases the computer software is acquired off the shelf. The agreement under which software is commonly acquired, the assessees acquire only a licence to use the computer software for their own purpose and there is as such no acquisition of any asset. The intellectual property rights in computer software is recognised and protected by the Copyright Act and as per the provisions of section 14(b) of the said statute, the use of a computer software under a licence is not exercise of a copyright. The acquisition of computer software under licence could be considered as a purchase of a copyrighted article wherein no copyright is transferred either as per the Copyright Act or even as per the U. S. Regulations on this subject. The ratio laid down by the hon'ble Supreme Court in the case of *TCS* [2004] 271 ITR 401 (SC) holding that computer software put in a medium of disk would be goods may lead to the inference that purchase of such disk is acquiring a tangible asset. If the disk, tape or floppy or other electronic medium in which the software is stored is by itself goods, then the assessee acquires the same, acquires a tangible asset. Computer software has not been defined in the Act but in Note 7 to Appendix I to the Income-tax Rules, it has been explained to include computer programme recorded on any disk, tape, perforated media or other information storage device. Therefore computer software in canned form is goods

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and a tangible asset by itself. These are covered in Note 7 to Appendix I to the Income-tax Rules and eligible for depreciation at 60 per cent.

6.4 Canned software contained in a medium are bought and sold. It is an article of value. It is sold in various forms like floppies, disks, CD-ROMs, punch cards, magnetic tapes, etc. A programme containing instructions in computer language is subject matter of a licence. It has its value to the buyer. It is useful to the person who intends to use the hardware, viz., the computer in an effective manner so as to enable him to obtain the desired results. It indisputably becomes an object of trade and commerce.

'Canned software' means that is not specifically created for a particular consumer. The sale or lease of, or granting a licence to use, canned software is not automatic data processing and computer services, but is the sale of tangible personal property.

When the software marketed is canned software being a tangible property would be exigible to sales tax. These are eligible for depreciation at 60 per cent.

6.5 But, in the present case, the software is not acquired of the shelf. These are highly customised software and are developed by the appellant company. These cannot be clubbed with the kind of software purchased to run the hardware. Basically, there are two types of software programmes. The first is an operational programme which controls the hardware and actually makes the machine run ; it is fundamental and necessary to the functioning of the computer hardware itself. Secondly, there is an applicational programme which is a type of programme designed to perform specific functions, such as preparation of the employee payroll, preparation of a loan amortisation schedule, or any other specific job which the computer is capable of performing. Applicational programmes instruct the central processing unit of the computer to perform the fundamental computations, comparisons, and sequential steps required to take incoming information and compute the desired output. (*Commerce Union Bank* v. *Tidwell* 538 SW. 2d. 405). The 60 per cent. rate for depreciation is stipulated for (i) computer software acquired off the shelf, (ii) operational software that controls hardware, (iii) where the software is an integral part of the related hardware, etc. In these cases these software which are recorded in any medium becomes tangible asset.

6.6 In the present case, we are concerned with softwares developed by the assessee, itself. Where the software is not an integral part of

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the related hardware, computer software is treated as an intangible asset (Accounting Standard 26 under definition Sl. No. 10).

6.7 The assessee submitted that it developed software relating to animation graphics and special effects, based on which several animation films have been produced by it, some even nominated for the Oscar Awards. The computer animation and special effects in the form of computer software and are referred to as digital content, stored in the hard disc of the computer.

6.8 The expenditure incurred by the assessee on development of software is capital in nature. The assessee had not incurred expenditure towards any asset which is depreciable under the provisions of the Income-tax Act. I place reliance on the decision in the case of *Hylam Ltd.* v. *CIT* [1973] 87 ITR 310 (AP) for the proposition that if the expenditure was incurred for initial outlay or acquiring or bringing into existence an asset of enduring nature for the business of the assessee or for expansion of the assessee's business or for substantial replacement, it will be treated capital expenditure.

6.9 *Software* : A computer software is a set of commands, on the basis of which the computer may be directed to perform the desired function. Software is a series of instructions. While it may be housed in a floppy disc or a CD-ROM or the hard disc of the computer, the item referred to as software is the series of commands that operates the computer. Though the floppy disc, the CD-ROM and the hard disc are each tangible commodities, that could be bought, sold and resold, the software embedded in these media are intangible and fall into a very different category.

In the book *Software Engineering* by Roger S. Pressman, it has been stated that a software is an instruction that when executed provides desired function and performances. It is stated that a software is composed of programmes, data and documents. Each of these items comprises a configuration that is created as part of the software engineering process.

The definitions of 'computer programme' in the Copyright Act, 1957 read as follows :

'"Computer programme" means a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result.'

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Majority of the U. S. courts have held that software is an intangible property.

6.10 The apex court referred to the judgments of the American courts in the cases of *Commerce Union Bank* v. *Tidwell* 538 S.W.2d 405 ; *State of Alabama* v. *Central Computer Services, Inc.* 349 So.2d 1156 ; *First National Bank of Fort Worth* v. *Bob Bullock*, 584 S.W.2d 548 ; *First National Bank of Springfield* v. *Department. of Revenue* 421 NE2d 175 ; *CompuServe Inc.* v. *Lindley* 535 N.E. 2D 360 and *Northeast Datacom, Inc.* v. *City of Wallingford*, 563 A2d 688 holding that computer software is intangible personal property. *Infotech Software Dealers* v. *Union of India* on August 24, 2010 (Mad) W. P. Nos. 3811 and 18886 of 2009.

6.11 In *Commerce Union Bank* v. *Tidwell* (Tenn. 1976), 538 S.W.2d 405, the Supreme Court of Tennessee held that computer software in the form of magnetic tapes or punch cards is intangible personal property and therefore not subject to that State's sales and use tax. The court reasoned that only information was being created and sold, 'and the magnetic tapes which contain this information are only a method of transmitting these intellectual creations from the originator to the user'. It is merely incidental that these intangibles are transmitted by way of a tangible reel of tape that is not even retained by the user.

In the case of *First National Bank* v. *Bullock* (Tex. Civ. App. 1979), 584 S.W.2d 548, the bank obtained licences to use four programmes, that is, software, which instructed the bank's computer to perform deposit and lending functions and process general accounting. The information was contained, on magnetic tapes. The court stated that it would look to the 'essence of the transaction' to determine whether the property purchased was tangible or intangible. The court held that, since the information on the tapes could have been communicated in several different ways, and the computer could even have been programmed over the telephone or by hand, the essence of the purchase was not the tapes, but the process which enabled the computer to function. The software was therefore in essence intangible property.

In *St Albans City and District Council* v. *International Computers Ltd.* 1997 FSR 251 Sir lain Glidewell in deciding on whether programmes were goods, commented on tangibility. He referred to the software or programmes as 'the intangible instructions or commands'.

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6.12 The courts have held that software is intrinsically incorporeal and that it is mere intangible 'knowledge' which 'rests in the machine'. (*District of Columbia* v. *Universal Computer Assoc., Inc.*, 465 F.2d 615, 618 (D.C.)). This has been quoted or paraphrased with approval in other decisions (*State* v. *Central Computer Servs., Inc.*, 349 So. 2d 1160, 1162 (Ala. 1977, *Honeywell Information Sysa., Inc.* v. *Board of Assessment Appeals* [1980] 7 Computer L. Serv. Rep. (Bigelow) 486, 491 (Colo. Dist Ct. 1975) ; *Nova Computing Servs., Inc.* v. *Askew* [1980] 16 Computer L. Serv. Rep. (Bigelow) 18, 27 (Fla. Div. Admin. Hearings 1976) ; *Commerce Union Bank* v. *Tidwell*, 538 S.W.2d 405, 408 (Tenn. 1976)). Because the tape, disk, card, or other transferring medium may be stored, returned, or destroyed after being used by the vendee machine, the universal court reasoned that the visible manifestation of software-the medium-is inconsequential to the transaction.

Therefore, the court assumed, the object of the transaction must be intangible 'knowledge' because the medium is inconsequential.

6.13 Thus, the software developed by the appellant is therefore in essence intangible property. Thus, it will not fall in the categories of 'computer and softwares' indicated in Appendix I (Part A) which deals only with tangible assets. Since the softwares developed by the assessee-company is its intangible assets, these are entitled for depreciation as mentioned in Part B of Appendix I which for the relevant assessment year is 25 per cent.

6.14 Some of the judicial pronouncements are also relevant to mention here.

(i) Licence acquired by the assessee to use a particular computer software amounted to acquisition of technical know-how and the Assessing Officer was justified in treating the same as intangible asset eligible for depreciation at 25 per cent. for the relevant assessment year ; payment was not deductible in its entirety as revenue expenditure. *Sudarshan Chemical Industries Ltd.* v. *Asst. CIT* [2008] 114 TTJ (Pune) 131 ; [2008] 110 ITD 171 (Pune)

(ii) Since the assessee itself has claimed website development expenses as part of block of assets on which depreciation has been claimed and allowed, the same cannot be treated as revenue expenditure. Depreciation at 25 per cent. applicable on intangible assets is allowable on such expenditure software development expenditure *Makemytrip (India) (P.) Ltd.* v. *Dy. CIT* [2012] 51 SOT 19 (Delhi) ; [2012] 147 TTJ (Delhi) 231 ; [2012] 72 DTR (Delhi) (Trib) 466.

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(iii) The assessee being a company engaged in business of software development as well as sales and its exports—the assessee was eligible for depreciation on intangible assets acquired by it. *Dy. CIT* v. *Netvision Web Technologies Ltd.* [2013] 37 CCH 280 (Ahd. Trib.)

(iv) In the case of *Dy. CIT* v. *Honda Siel Cars Ltd.* [2013] 21 ITR (Trib) 497 (Delhi) ; [2013] 142 ITD 783 (Delhi), it is held (page 510 of 21 ITR (Trib)) :

'The Special Bench further observed that the rights which an assessee acquires by purchasing the disk or magnetic medium containing the computer software with limited or absolute right to use ; the same by itself would satisfy the requirements of the plant. The assessee's ownership of limited right over the tangible asset is to conclude that the assessee is the owner of the plant. It was also observed that in the case of *Maruti Udyog Ltd.* v. *Dy. CIT* [2005] 92 ITD 119, *Radha Krishna Foodland Ltd. ; Escorts Ltd.* v. *Asst. CIT* [2006] 8 SOT 167 (Delhi) and *Hero Honda Motors Ltd* v. *Jt. CIT* [2006] 103 ITD 157 (Delhi) the conclusion that the expenditure on purchase of computer software was capital proceeded on the footing that the purchase was an outright purchase and that software was an intangible asset.'

6.15 A recent ruling in the case of *Makemytrip (India) Pvt. Ltd.* v. *Dy. CIT* [2012] 19 taxmann.com 137 (Delhi), by the Income-tax Appellate Tribunal (ITAT), New Delhi, is pertinent. In this case, the Tribunal held that the assessee had claimed website development expenses as capital expenditure and depreciation at the rate of 60 per cent. treating the website as software. However, the Delhi Income-tax Appellate Tribunal held that a website cannot be considered as software. Rather, it should be classified as an intangible asset and only 25 per cent of its cost is allowable as depreciation.

6.16 One of the arguments by the assessee is that the Supreme Court has considered the identical question of classification of the 'digital content' concluding that the software is liable to be classified as 'information technology software'. This judgment was in the assessee's own case relating to issue of customs duty. The Assessing Officer has dealt this argument in his assessment order. The issue considered by the hon'ble Supreme Court is whether the 'motion capture animation films' is computer software and is eligible for exemption from customs duty or not. The Supreme Court has held that the same are computer software after verifying the contents and with relevance to the Customs Act. The Customs Act deals with the goods at the point of entry and the subsequent state of the goods is

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not relevant to the grant of exemption under the Act. Further, the issue herein is whether the asset is a tangible asset or intangible asset under the Income-tax Act. As the decision of the Supreme Court is on different context and the Supreme Court has not examined with relevance to the Income-tax Act, relying on the same by the assessee is not correct.

6.17 I have already dealt with the difference between the software/developed/acquired and copy of computer software purchased by it. In the present case, software developed is its intellectual property right having enduring benefit, as claimed by the assessee that it is eligible to use the animation in sequels, etc. These items are in the form of developed software and are intangible assets of the company in the first place.

6.18 According to Accounting Standard 26 (AS-26) issued by the Institute of Chartered Accountants of India (ICAI) also all software that are developed either within an organisation or availed of through other sources, and provide enduring benefits enabling earnings in the present and in future, should be treated as intangible capital assets.

In view of the above reasonings of judicial pronouncements, I held that this software which were developed by the assessee-company are entitled for depreciation at 25 per cent. Hence, the assessment made by the Assessing Officer in this respect is justified and accordingly, ground Nos. a, b, c, d, e and f set out in the grounds of appeal are dismissed.

In the result, the appeal filed by the appellant is dismissed."

5 Aggrieved by an appellate order passed by the learned Commissioner of Income-tax (Appeals), the assessee has filed an appeal with the Tribunal. The learned counsel for the assessee submitted that the assessee is a software developer and the issue before the Tribunal is whether the assessee is entitled for depreciation at 25 per cent. or 60 per cent. on computer software. It was submitted that in the first round matter went up to the Tribunal at the behest of the Revenue and the Tribunal was pleased to set aside the matter to file of the Assessing Officer for fresh adjudication of the issue. It was submitted that in the second round of litigation both the Assessing Officer as well the learned Commissioner of Income-tax (Appeals) has decided the issue against the assessee. It was submitted that the assessee developed animation software. Our attention was drawn to *Explanation 2* to section 10B of the 1961 Act and it was submitted that computer software is eligible for deprecation at 60 per cent. Our attention was drawn to the assessment order passed by the Assessing Officer as well

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the appellate order passed by the learned Commissioner of Income-tax (Appeals). It was submitted that in the assessee's own case in the context of Customs law, the hon'ble Supreme Court has held in *Commissioner of Customs* v. *Pentamedia Graphics Ltd.* that the "motion capture animation films" would qualify to be classified as information technology software, in Civil Appeal No. 2576 of 2001 vide judgment dated May 9, 2006. The learned counsel for the assessee also relied upon the decision of the Income-tax Appellate Tribunal, Chennai Benches in *Laser Soft Infosystems Ltd.* v. *ITO* (I. T. A. No. 107/Mds/2012 vide orders dated January 31, 2013). The assessee's counsel also brought to our notice, order passed by the Income-tax Appellate Tribunal, Chennai in the assessee's own case in the first round in *Asst. CIT* v. *Pentamedia Graphics Ltd.* (I. T. A. No. 144/Mds/2011 dated September 9, 2011). The learned Departmental representative on the other hand submitted that animation software is tangible/intangible asset. Our attention was drawn to the assessment order para 14.3/page 15. Our attention was drawn to the appellate order passed by the learned Commissioner of Income-tax (Appeals). It was submitted that the digital content developed by the assessee is intangible asset. It was submitted that the hon'ble Supreme Court decision is in the context of Customs laws and has no applicability so far as income-tax law is concerned. The learned Departmental representative relied upon the appellate order passed by the learned Commissioner of Income-tax (Appeals).

We have considered the rival contentions and perused the material on 6
record included the cited case law. We have observed that the limited issue for our adjudication is as to eligibility of the assessee for depreciation on "digital content" developed by the assessee and which is held by the assessee as an "asset" which is used in various films by the assessee, is to be allowed at the rate of 60 per cent. being computer software or it is to be allowed at 25 per cent. as an intangible asset. The Revenue is contending that this digital content developed by the assessee is merely intangible asset which entitles the assessee for depreciation at 25 per cent. while the assessee is contending that the same is computer software and the assessee is eligible for depreciation at 60 per cent. In any case the effect will be tax neutral as overall depreciation spread over several years will ultimately cannot exceed in all cumulatively cost of the asset. The assessee has contended that it has developed software relating to animation graphics and special effects, based on which several animation films have been produced by it, even some nominated for the Oscar Awards. The computer animation and special effects in the form of computer software are referred to as 'digital content', stored in the hard disc of the computer. Thus, the assessee

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is claiming that "digital content" developed by it is essentially computer software in so far as it related to the computer programme that has been recorded on a storage device such as a disc. The assessee has claimed that the content developed is utilised in the multimedia and entertainment industry and, by is very nature, is a series of software programme recorded on storage device. As per rule 5 of the Income-tax Rules, 1962, the depreciation in respect of block of assets shall be calculated at percentages specified in Appendix I to the Income-tax Rules, 1962 on the written down value of such block of assets as are used for purposes of the business or profession of the assessee at any time during the previous year. In Appendix I to the Income-tax Rules, 1962 at Part A under clause III—Machinery and plant at sub-clause (5), it is specified that computers including computer software shall be eligible for depreciation at 60 per cent. The said also refer to Note number 7 which clarify that "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device. While Part B specifies "intangible assets" which include know-how, patents, copy rights, trade marks, licences, franchise or any other business or commercial rights of similar nature which shall entitled the assessee for depreciation at 25 per cent. The assessee has relied upon the decision of the hon'ble Supreme Court in its own case rendered in the context of customs laws in *Commissioner of Customs* v. *Pentamedia Graphics Ltd.* (Appeal (Civil) No. 2576 of 2001 dated May 9, 2006), wherein in the context of customs notifications as were applicable any kind of data which is capable of being manipulated by means of automatic data processing machine would be covered by the term "information technology software". Presently, we are concerned with the 1961 Act and the relevant entry in Appendix I reads as under :

> "PART A
>
> Tangible assets . . .
>
> III Machinery and plant . . .
>
> (5) Computers including computer software (see note 7 below this table) (60).
>
> Note 7 stipulates 'computer software' means any computer programme recorded in any disc, tape, perforated media or other information storage device."

Thus, as per note 7, computer software has been given restricted coverage to "computer programme. . ." vis-a-vis Customs notifications referred to by the hon'ble Supreme Court in the aforestated case in the assessee's own case, wherein the said custom notifications referred to "information technology software" means any representation of instructions, data, sound

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or image including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine to be covered by the term "information technology software". Thus, the coverage under customs laws was very wide while we are dealing with the 1961 Act read with the 1962 Rules and coverage of the term "computer software" is restrictive to computer programme which is recorded in any disc, tape, perforated media or other information storage device. Thus, as could be seen that the assessee has developed digital content which is held by the assessee as an asset and is used in various films, etc., after being manipulated. This in our considered view cannot be equated with a computer programme but what is held by the assessee is a digital content which is used by the assessee in various films, etc. The computer animation and special effects are digital content which are stored in the hard disc of the computer. This digital content developed by the assessee is utilised in the multimedia and entertainment industry and at best it is a copyrighted intangible asset owned by the assessee which is manipulated by the assessee to be used in various films, etc., but to contend that it is a computer software within the meaning of Appendix I will be far fetched as it is not a computer programme. If the language in the statute is clear and unambiguous then strict interpretation has to be done and it is well-settled that there is no equity in taxing statute. Once the definition is given in the statute itself, then there is no need to refer to other statute and restrictive definition as is given in the 1961 Act read with the 1962 Rules shall apply.

In Wikipedia, computer programme is defined as collection of instructions that can be executed by a computer to perform a specific task. Most computer devices require programmes to function properly. A computer programme is usually written by a computer programmer in a programming language. From the programme in its human-readable form of source code, a compiler or assembler can derive machine code—a form consisting of instructions that the computer can directly execute. Alternatively, a computer programme may be executed with the aid of an interpreter.

In Wikipedia, computer programming is defined as a collection of computer programmes, libraries, and related data are referred to as software. Computer programmes may be categorised along functional lines, such as application software and system software. The underlying method used for some calculation or manipulation is known as an algorithm. Computer programming is the process of designing and building an executable computer programme to accomplish a specific computing result. Programming

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involves tasks such as : analysis, generating algorithms, profiling algorithms' accuracy and resource consumption, and the implementation of algorithms in a chosen programming language (commonly referred to as coding). The source code of a programme is written in one or more languages that are intelligible to programmers, rather than machine code, which is directly executed by the central processing unit. The purpose of programming is to find a sequence of instructions that will automate the performance of a task (which can be as complex as an operating system) on a computer, often for solving a given problem. The process of programming thus often requires expertise in several different subjects, including knowledge of the application domain, specialised algorithms, and formal logic. Tasks accompanying and related to programming include testing, debugging, source code maintenance, implementation of build systems, and management of derived artifacts, such as the machine code of computer programmes. These might be considered part of the programming process, but often the term "software" development is used for this larger process with the term "programming, implementation, or coding" reserved for the actual writing of code.

The scope of "information technology software" as is referred to in the hon'ble Supreme Court judgment in the assessee's own case was in the context of Customs laws which was very wide definition and hence we cannot draw an analogy in the 1961 Act read with the 1962 Rules. Thus, to say that digital content developed by the assessee can be equated with computer programme is far fetched but rather it is a copyrighted material developed by the assessee which is stored in computer. This digital content was manipulated by the assessee to be used in different films but still it cannot be categorised to a higher pedestal of being termed as "computer programme" rather it still retains the character of copyrighted material being intangible asset and in our considered view, the assessee is eligible for depreciation at 25 per cent. as these copyrighted material developed by the assessee being "digital content" which is used by the assessee in various films, etc. Thus, we concur with the view of the learned Commissioner of Income-tax (Appeals) who has passed the well reasoned order which we affirm and dismiss the appeal of the assessee on this issue. Thus, ground numbers 2 to 8 stand dismissed. Ground numbers 1 and 10 are general in nature and does not require separate adjudication while ground number 9 is consequential in nature. We order accordingly.

7 In the result the appeal in I. T. A. No. 1406/Chennai/2015 for the assessment year 2007-08 stand dismissed as indicated above. We order accordingly.

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I. T. A. No. 1407/Chennai/2015 for the assessment year 2009-10

The first issue in this appeal filed by the assessee for the assessment year 2009-10 concerns with the depreciation on "digital content". This issue is decided by us against the assessee by us while adjudicating the appeal for the assessment year 2007-08 in this common order. Our decision in I. T. A. No. 1406/Chennai/2015 for the assessment year 2007-08 shall apply mutatis mutandis to appeal in I. T. A. No. 1407/Chennai/2015 for the assessment year 2009-10 so far as depreciation on "digital content" is concerned. Thus, the assessee fails on this issue. Thus, ground numbers 2-8 stand dismissed. We order accordingly. **8**

The second effective issue raised by the assessee in its appeal for the assessment year 2009-10 concerns with the disallowance of expenses incurred by the assessee in relation to earning of an exempt income by the Assessing Officer by invoking the provisions of section 14A of the 1961 Act read with rule 8D(2)(iii) of the 1962 Rules. The Assessing Officer has disallowed the expenses by invoking rule 8D(2)(iii) of the 1962 Rules by applying 0.5 per cent. of the average investments. The learned Commissioner of Income-tax (Appeals) has affirmed the decision of the Assessing Officer. It is no more res integra that rule 8D of the 1962 Rules shall be applicable for the impugned assessment year. The only grievance raised by the assessee before us is that the assessee has made investments in foreign companies from which dividend income was received during the year under consideration on which the assessee has paid due taxes to the Government as the said dividend income was not exempt from tax and was in fact chargeable to tax. It is prayed that the said investments in foreign companies be excluded while applying section 14A of the 1961 Act read with rule 8D of the 1962 Rules. We find merit in the contention of the assessee that once the income is chargeable to income-tax, section 14A shall have no applicability. We are restoring the matter back to the file of the Assessing Officer for verification of the contention of the assessee and readjudicate on the merits in accordance with law after due verifications and all such foreign investments on which dividend income has suffered taxation in India shall stand excluded. The second contention of the assessee before us is that the assessee has made investments in certain Indian companies from which no dividend income was received during the year and hence no exemption was claimed. It is prayed that such investments in Indian companies from which no dividend income was received during the year be excluded while computing disallowance of expenditure under section 14A of the 1961 Act. We find merit in the contentions of the assessee that the investments in Indian companies which did not yield exempt **9**

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income during the year cannot be included for computing disallowance of expenditure under section 14A read with rule 8D of the 1962 Rules and we are restoring the matter back to the file of the Assessing Officer for verification of the contentions of the assessee and to readjudicate the matter on the merits in accordance with law. Thus, all those investments in Indian companies which did not yield exempt dividend income during the year shall be excluded while computing the disallowance of expenditure under section 14A read with rule 8D(2)(iii) of the 1962 Rules. The decision of the Special Bench of the Income-tax Appellate Tribunal, Delhi in the case of *Asst. CIT* v. *Vireet Investment P. Ltd.* [2017] 58 ITR (Trib) 313 (Delhi) [SB]; [2017] 165 ITD 27 (Delhi SB-Trib.) is relevant. This ground numbers 9-11 are partly allowed for statistical purposes as indicated above. We order accordingly.

10 Ground numbers 1 and 13 are general in nature and do not require separate adjudication, while ground number 12 is consequential in nature. We order accordingly.

11 In the result, the appeal in I. T. A. No. 1407/Chennai/2015 for the assessment year 2009-10 is partly allowed for statistical purposes.

In the result, the appeal filed by the assessee in I. T. A. No. 1406/Chennai/2015 for the assessment year 2007-08 stands dismissed while appeal in I. T. A. No. 1407/Chennai/2015 for the assessment year 2009-10 stands partly allowed for statistical purposes. We order accordingly.

Order pronounced on the 8th day of May, 2020 in Chennai.

[2020] 80 ITR (Trib) 580 (Delhi)

[Before the Income-tax Appellate Tribunal — Delhi "B" Bench]

LANDBASE INDIA LTD.

v.

ASSISTANT COMMISSIONER OF INCOME-TAX

Ms. Sushma Chowla ***(Vice-President)*** and **Prashant Maharishi** ***(Accountant Member)***

May 14, 2020.

SS ▶ ITA 1961, s 32
AY ▶ 2013-14, 2014-15, 2016-17
HF ▶ Assessee

Depreciation—Assessee owning golf course and using for purpose of business as a tool of its business—Plant—Assessee entitled to depreciation—Income-tax Act, 1961, s. 32.

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CAPITAL OR REVENUE RECEIPT—SECURITY DEPOSIT—CAPITAL RECEIPT—INCOME-TAX ACT, 1961.

BUSINESS INCOME—ACCRUAL—MEMBERSHIP FEES—ASSESSEE RECEIVING FEES IN EARLIER YEARS PERTAINING TO SUBSEQUENT YEARS—AMOUNT TAXABLE IN YEAR TO WHICH IT PERTAINS.

The assessee was in the business of operation of a golf course, construction of hotels, housing complex and merchandising. The assessee claimed depreciation on the golf course at 15 per cent. considering it as plant and machinery. The Assessing Officer disallowed the claim on the ground that the golf course was developed on land and whatever improvement was made on that land, it remained land. According to him, only the value of land was enhanced by constructing the golf course thereon. Thus, land being not a depreciable asset, was not depreciable. The Commissioner (Appeals) held that the golf course was a building and depreciation should be allowed considering it as a building. On appeal :

Held, *that the golf course owned and used by the assessee for the purpose of the business was a tool of the business of the assessee. It functioned like a plant in the case of the assessee. Thus, the assessee was eligible for depreciation thereon at 15 per cent.*

LANDBASE INDIA LTD. *v.* ASST. CIT (I. T. A. Nos. 1030-31/Delhi/2019 dated August 26, 2019) *followed*.

The assessee received the sum of Rs. 13,00,016 on account of security deposit and membership fees from members and claimed it to be a capital receipt. The Assessing Officer considered the receipt a revenue receipt. The Commissioner (Appeals) confirmed the findings of the Assessing Officer. On appeal :

Held, *(i) that whenever income accrues to the assessee irrespective of the time of receipt of such income it was taxable as business income. Under the mercantile system of accounting, the assessee had an option to account for any income either on accrual or after accrual, on the basis of the method of accounting regularly followed by it. The entrance fee and membership fees received by the assessee should be accounted for as income only when they accrued to the assessee. Merely because the income, which pertained to subsequent years, was received by the assessee in earlier years it did not become the income of the earlier years under section 5 of the Income-tax Act, 1961 in the case of either business income or under section 28. Hence, the membership fee income of the assessee was chargeable to tax in the year to which it pertained.*

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(ii) That the refundable security deposit received from members of the assessee was a capital receipt and could not be charged to tax as income.

LANDBASE INDIA LTD. *v.* ASST. CIT (I. T. A. Nos. 1030-31/Delhi/2019 dated August 26, 2019) *followed.*

Cases referred to :

CIT *v.* Calcutta Stock Exchange Association Ltd. [1959] 36 ITR 222 (SC) (para 9)

CIT (Pr.) *v.* Gulmohar Green Golf and Country Club Ltd. [2017] 392 ITR 601 (Guj) (para 9)

CIT (Dy.) *v.* Jaypee Greens Ltd. (I. T. A. No. 3545-3547/Delhi/2009 dated March 9, 2010) (para 6)

CIT (Asst.) *v.* Victory Aqua Farm Ltd. [2015] 379 ITR 335 (SC) (para 6)

Delhi Stock Exchange Association Ltd. *v.* CIT [1961] 41 ITR 495 (SC) (paras 8, 9)

Landbase India Ltd. *v.* Asst. CIT (I. T. A. Nos. 1030-31/Delhi/2019 dated August 26, 2019) (para 6)

Moradabad Toll Road Co. Ltd *v.* Asst. CIT [2014] 369 ITR 403 (Delhi) (para 6)

I. T. A. Nos. 7269 to 7271/Delhi/2019 (assessment years 2013-14, 2014-15, 2016-17).

Rohit Jain, Advocate, and *Ms. Somiya Jain*, Chartered Accountant, for the assessee.

Amit Jain, Senior Departmental representative, for the Department.

ORDER

The order of the Bench was pronounced by

1 PRASHANT MAHARISHI ***(Accountant Member)***.—All these three appeals filed by the assessee for the three different assessment years related to the single issue largely and therefore, they are heard together and disposed of by this common order.

2 The lead first assessment year involved in this appeal is the assessment year 2013-14 and therefore, the facts related to that are narrated.

3 The assessee is a company engaged in the business of operation of golf course, construction of hotels, housing complex and merchandising. It filed its return of income at a loss of Rs. 2,01,87,486. The assessment under section 143(3) of the Income-tax Act, 1961 was passed by the learned Assistant Commissioner of Income-tax, Circle-15(1), New Delhi on March 3, 2016. The learned Assessing Officer disallowed depreciation of Rs. 12,28,317 on

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golf course. The assessee has claimed depreciation on golf course at 15 per cent. considering it as "plant and machinery". The learned Assessing Officer denied the depreciation for the reason that according to him golf course is developed on the land and whatever improvement is made on that land, it remain as a land. According to him, only the value of land is enhanced by constructing golf course thereon. Thus, according to him it is only land, which is not depreciable. Hence, it amounts to allowing depreciation on land, land being not a depreciable assets, he disallowed it.

The assessee challenged the same before the learned Commissioner of Income-tax (Appeals), he held that the golf course is a "building" and depreciation should be allowed considering the same as a "building". The assessee aggrieved with that order has preferred appeal before us. 4

Ground No. 1 the assessee challenges that depreciation on the golf course should be allowed considering it as "plant and machinery". 5

We have heard the rival contentions and find this issue has been considered by the co-ordinate Bench in the assessee's own case *Landbase India Ltd.* v. *Asst. CIT* (I. T. A. Nos. 1030-31/Delhi/2019 dated August 26, 2019) for the assessment years 2005-06 to 2011-12 wherein the co-ordinate Bench has held that the golf course is a plant and machinery and the assessee is eligible for depreciation thereon at 15 per cent. The co-ordinate Bench held so following the decision of the co-ordinate Bench in the case of another assessee as per para No. 13 as under : 6

> "13. In the present case also before us, the golf course owned and used by the assessee for the purpose of the business as a tool of the business of the assessee. It is functioning like a plant in the case of the assessee. Further, it is not the case of the Revenue that the assessee has claimed any depreciation on the land. It is similar to the depreciation on pond allowed in the case of an aquaculture company by the honourable Supreme Court in *Asst. CIT* v. *Victory Aqua Farm Ltd.* [2015] 379 ITR 335 (SC) and the honourable Gujarat High Court holding that mineral oil well also constitute a plant. The learned Commissioner of Income-tax (Appeals) is not correct in saying that playing equipment, creating landscaping, holes, ponds and others are being done in the regular course to facilitate the game of golf and not into any production of goods and services. In fact, by creating these facilities, the assessee has created a service facility for its members and it produces revenue for the assessee. It is not always necessary that each plant should produce certain other tangible goods. Further, in the case of the assessee in certain assessment years under section 143(3) of the Income-tax Act the claim of the depreciation holding the

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golf course as plant has been accepted by the Revenue and in subsequent years in the assessment years 2006-07 to 2009-10 also the claim of the assessee is accepted. In fact the claim of depreciation on golf course as a plant stands accepted in the assessment year 1998-99 to the assessment year 2000-01, 2002-03 and 2006-07 to 2009-10. Even otherwise, the co-ordinate Bench in the case of *Dy. CIT* v. *Jaypee Greens Ltd.* (I. T. A. Nos. 3545-3547/Delhi/2009) on identical facts and circumstances considered golf course as plant and depreciation at the rate of 25 per cent. was allowed holding that the Assessing Officer himself has allowed depreciation at that rate in past in that particular case. The decision relied upon by the learned Commissioner of Income-tax-Departmental representative that toll road does not qualify as a plant for higher rate of depreciation as held by the honourable Delhi High Court in *Moradabad Toll Road Co. Ltd.* v. *Asst. CIT* [2014] 369 ITR 403 (Delhi) ; [2014] 52 taxmann.com 21 (Delhi) was decided as 'road' was specifically considered as part of building in Part A of Appendix I to the Income tax Rules, 1962. Thus, the fact of that case is distinguishable. Further, it was not stated before us that the Revenue has not accepted the decision of the co-ordinate Bench in *Dy. CIT* v. *Jaypee Greens Ltd.* (I. T. A. Nos. 3545-3547/Delhi/2009) where golf course was held to be plant. Therefore, it stands concluded that golf course is a plant looking to the nature of business of the assessee. Further, the judicial precedents relied upon by the parties also only lays down the proposition established by the higher judicial forum supports the above view. In view of this, ground No. 1 of the appeal of the assessee is allowed reversing the views of the lower authorities, holding that golf course is a plant on which assessee is entitled to the depreciation at the rate of 25 per cent. under the Income-tax Act."

7 As there is no change in the facts and circumstances, we respectfully following the decision of the co-ordinate Bench, allow ground No. 1 of the appeal directing the learned Assessing Officer to grant depreciation on cost of developing golf course on land considering it as plant and machinery.

8 The second ground of appeal is with respect to the addition of Rs. 13,00,016 on account of security deposit and membership fees. The assessee received the above sum from the members and claims it to be a capital receipt. The learned Assessing Officer considered the same as revenue receipt and thus charges to tax. The assessee preferred an appeal before the learned Commissioner of Income-tax (Appeals) who also vide para No. 8 dismissed the appeal of the assessee therefore ; the assessee is in appeal before us.

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We have heard the rival parties and found that identical issue has been considered by the co-ordinate Bench in the assessee's own case for earlier years. The co-ordinate Bench in its above order for the assessment year 2005-06 has dealt with this issue in para No. 38 onwards as under : 9

"38. We have carefully considered the rival contentions and perused the orders of the lower authorities on the issue. The learned Commissioner of Income-tax (Appeals) has decided the whole issue as per paragraph numbers 7.1-7.7 of his order. Undisputedly, the assessee is running a golf course and making the revenue collection by way of refundable security deposit and membership fees from the members. This indicates that the assets are fully operation and the members are deriving a benefit from the use of the assets. As such, it is not in dispute that the appellant is carrying on the business of running of golf course. Facts shows that the assessee has received certain security deposits and membership fees collected by the appellant from the members along with the borrowed funds were utilised for the creation of the fixed assets by the assessee. The learned Commissioner of Income-tax (Appeals) following the decision of the honourable Supreme Court in *CIT* v. *Calcutta Stock Exchange Association Ltd.* [1959] 36 ITR 222 (SC) and *Delhi Stock Exchange Association Ltd.* v. *CIT* [1961] 41 ITR 495 (SC) held that the security deposit received from the members are not capital receipt but are revenue receipts and are taxable as income of the appellant. He further held that the nature of such security deposit is whether refundable or non-refundable is immaterial. He further noted that though the assessee has offered the golf course membership fees of INR 3,52,88,416 as income in subsequent years such deferment of income is not relevant on the facts and circumstances of the case of the appellant as the membership fees received by the assessee is also assessable as income for the assessment year in which it is received. He further noted that it is a fact that unless the security deposits and membership fees were paid by the members, the appellant would not have granted the membership of the golf club to those members. He therefore held that both this sum of the security deposit as well as the membership fee has correctly been charged by the learned Assessing Officer as income of the assessee. The learned Commissioner of Income-tax (Appeals) with respect to the entrance fees and membership fees has followed the decision of the honourable Supreme Court in the case of *CIT* v. *Calcutta Stock Exchange Association Ltd.* [1959] 36 ITR 222 (SC) and *Delhi Stock Exchange Association Ltd.* v. *CIT*

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[1961] 41 ITR 495 (SC) wherein it has been held that entrance fee/ membership fees received from the members is an income.

39. On a careful analysis of the order of the learned Commissioner of Income-tax (Appeals), according to us he has wrongly applied the decision of the *CIT* v. *Calcutta Stock Exchange Association Ltd.* [1959] 36 ITR 222 (SC) and *Delhi Stock Exchange Association Ltd.* v. *CIT* [1961] 41 ITR 495 (SC). In *Calcutta Stock Exchange Association Ltd.*, the issue of the monthly fees received by the assessee. Therefore, it cannot be said that if the fees received which is pertaining to the year itself it cannot be said not to be the income of the assessee. In the case of the assessee, the assessee has received advance membership fees for which the services were to be rendered in subsequent years and the assessee has already offered such income in the subsequent years on accrual basis. It is not the case of the Revenue that the assessee has not offered golf course membership fees income in the year to which it pertains to. It is also not the case of the Revenue that the assessee provides all the services to the members in the year in which the membership fee is received, and in subsequent years, no services were rendered. The membership fees are chargeable to tax under the provisions of the business income. The assessee follows undisputedly, mercantile/accrual system of accounting. Therefore, income/expenses of the assessee are also required to be recorded as income only based on accrual system. Thus, whenever the income accrues to the assessee irrespective of the time of receipt of such income is taxable as business income. Under the mercantile system of accounting, the assessee has an option to account for any income either on accrual or after accrual, on the basis of the method of accounting regularly followed by it. So far as the issue of the entrance fee and membership fees received by the assessee, we are of the opinion that it should be accounted for as income only when it accrues to the assessee. Merely because the income, which is pertaining to subsequent years, is received by the assessee in earlier years does not become the income of the earlier years under section 5 of the Income-tax Act in the case of either business income or under section 28. Hence, according to us, the membership fee income of the assessee should be chargeable to tax in the year to which it pertains. Therefore, we reverse the finding of the learned Commissioner of Income-tax (Appeals) in holding that a sum of INR 3,52,88,416 received as golf course membership fee is chargeable to tax as income. As such, it is the claim of the assessee that subsequently such income has already

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been offered for taxation therefore for the year to which it pertains. Therefore, we direct the learned Assessing Officer to tax the above income of INR 3,52,88,416 as income for the impugned assessment year to which it pertains to. Therefore, if the assessee has offered the income, to the year to which it pertains to, the addition is required to be deleted. However, it is not known that how much income is pertaining to which year, therefore, we direct the assessee to show before the Assessing Officer about the taxability of this income in the subsequent years on accrual basis. The learned Assessing Officer may verify the same and if the income has been offered in subsequent years on accrual basis, the addition deserves to be deleted in this year.

40. With respect to the issue of taxability of the security deposit against the golf course membership fee of INR 31,14,60,578, the claim of the assessee is that such security deposit is refundable in nature. It is required to be refunded to the members at the end of the specified years or as per the terms of the membership. If the membership is refundable to the members, it becomes a liability of the assessee, which is required to be repaid. It is not the case of the Revenue that the assessee do not refund or under no obligation to refund the above sum at the end of the specified period or on happening of certain events. The identical issue arose before the honourable Gujarat High Court in *Pr. CIT* v. *Gulmohar Green Golf and Country Club Ltd*. [2017] 392 ITR 601 (Guj) wherein it has been held that the security deposit recovered from the members at the time of their enrolment as a member is refundable on occurrence of the contingency mentioned in the rules and regulation and bylaws, therefore, it is required to be treated as a deposit, thus, a capital receipt. Therefore, it was held that it is not an income of the assessee. As in the case of the assessee also the security deposit is refundable hence respectfully following the decision of the honourable Gujarat High Court in *Pr. CIT* v. *Gulmohar Green Golf and Country Club Ltd.* [2017] 392 ITR 601 (Guj), we also hold that the sum of refundable security deposit received from the members of the assessee is a capital receipt and cannot be charged to tax as income. Accordingly, we direct the learned Assessing Officer to delete the addition to the extent of refundable deposit received from the members. Accordingly, ground Nos. 2 and 3 of the appeal of the assessee is partly allowed."

There is no change in the facts and circumstances of the case and therefore, for the reason given by the co-ordinate Bench and respectfully following the same, we direct the learned Assessing Officer to delete the

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addition of Rs. 13,00,016 on account of security deposit and membership fees received. Accordingly, ground No. 2 of the appeal for the assessment year 2013-14 is allowed.

11 Accordingly, the appeal of the assessee for the assessment year 2013-14 is allowed.

12 Coming to the appeal of the assessee for the assessment year 2014-15, which involves the only issue of allowability of depreciation on golf course, which has been decided by us, as per ground No. 1 of the appeal of the assessee for the assessment year 2013-14. Therefore, for the similar reasons, we allow only ground of Appeal No. 1 of appeal of the assessee for the assessment year 2014-15.

13 Thus, the appeal of the assessee for the assessment year 2014-15 is allowed.

14 Now, we come to the appeal of the assessee for the assessment year 2016-17.

15 Ground No. 1 of the appeal is with respect to depreciation on account of golf course. For the reason given by us, while allowing ground No. 1 of the appeal of the assessee for the assessment year 2013-14, we direct the learned Assessing Officer to allow depreciation on cost of gold course developed on the land considering the same as "plant and machinery". Thus, ground No. 1 of the appeal is allowed.

16 Ground No. 2 of the appeal is identical to ground No. 2 of the appeal of the assessee for the assessment year 2013-14 with respect to taxation of security deposit and membership fees. As we have already allowed ground No. 2 of the appeal of the assessee for the assessment year 2013-14, for the similar reasons, we also allow ground No. 2 of this appeal.

17 Accordingly, the appeal of the assessee for the assessment year 2016-17 is allowed.

18 In the result, all the three appeals of the assessee are allowed.

Order pronounced in the court on May 14, 2020.

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[2020] 80 ITR (Trib) 589 (Delhi)

[BEFORE THE INCOME-TAX APPELLATE TRIBUNAL — DELHI "D" BENCH]

VOITH PAPER GMBH

v.

DEPUTY DIRECTOR OF INCOME-TAX

O. P. KANT *(Accountant Member)* and
K. N. CHARY *(Judicial Member)*

February 21, 2020.

SS ▸ ITA 1961, ss 9(1)(i), 234B
AY ▸ 2010-11
HF ▸ Department

NON-RESIDENT—TAXABILITY IN INDIA—INCOME DEEMED TO ACCRUE OR ARISE IN INDIA—CONTRACTS FOR SUPPLY AND SERVICE OF MACHINERY IN CONNECTION WITH SETTING UP OF PLANT—MACHINERY COMPONENTS IMPORTED IN INDIA CUSTOM-MADE PLANT FOR BUYER—ASSESSEE ENTRUSTED WORK OF COMMISSIONING OF PLANT IN VIEW OF EXPERTISE IN FIELD—SUPPLY AND SERVICE CONTRACTS REPRESENTING A SINGLE, COMPOSITE TURNKEY WORKS CONTRACT—ASSESSEE'S ACTIVITIES IN INDIA REPRESENTING REAL AND INTIMATE RELATIONSHIP BETWEEN ACTIVITIES OF ASSESSEE DONE OUTSIDE INDIA AND THOSE DONE INSIDE INDIA—BUSINESS CONNECTION IN INDIA—INCOME DEEMED TO ACCRUE OR ARISE IN INDIA—THIRTY-FIVE PER CENT. OF PROFIT ATTRIBUTED TO PERMANENT ESTABLISHMENT—INCOME-TAX ACT, 1961, S. 9(1)(i)—DOUBLE TAXATION AVOIDANCE AGREEMENT BETWEEN INDIA AND AUSTRIA, ART. 5(2).

ADVANCE TAX—INTEREST—NON-RESIDENT—ASSESSEE ACCEPTING EXISTENCE OF PERMANENT ESTABLISHMENT—ASSESSEE NOT ENTITLED TO CONTEND THAT IT WAS RESPONSIBILITY OF DEDUCTOR TO DEDUCT TAX AT SOURCE—ASSESSEE LIABLE FOR INTEREST—INCOME-TAX ACT, 1961, S. 234B.

The assessee, an Austrian company, was one of the market leaders in concept, technology, project planning, sale, engineering, processing, sourcing and marketing of board and packaging paper machines. It entered into two contracts with CPPC, a division of C, for equipment supply and service for commissioning of 620 TPD multilayer packaging coated board plant. The supply included for engineering, designing, manufacturing, drawing and supplying of machinery for the plant and service included supervision of erection, start-up, training, commissioning and performance test of the machinery. According to the assessee, the income in respect of offshore supply of

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equipment was not taxable under the provisions of the Income-tax Act, 1961 as well as under the Double Tax Avoidance Agreement between India and Austria. It had no fixed place of business in India in terms of article 5(2) of the Agreement as far as offshore supply of machinery. Therefore, for the assessment year 2010-11, it provided details of the contracts for equipment supply and service and declared nil income in the status of a non-resident. The Assessing Officer carried out benchmarking of distribution function of the permanent establishment and based on the set of comparables, computed the average margin for distribution services at 9.75 per cent. The Assessing Officer issued a show-cause notice to the assessee stating that since it had a permanent establishment in India, in the form of a project office under article 7(1) of the Double Taxation Avoidance Agreement between India and Austria, the profits of the enterprise attributable to the permanent establishment in India would be taxable in India, he proposed a profit mark-up at the average margin of 9.75 per cent. on supply of Rs. 472,97,97,680 which amounted to Rs. 46,11,55,273. The Assessing Officer concluded that the contract of supply and service in relation to commission of the plant was a composite contract income from which was taxable under section 9(1) as income deemed to accrue or arise in India through or from the business connection in India. The Dispute Resolution Panel confirmed the findings of the Assessing Officer which culminated in a final assessment. On appeal :

Held, *(i) that the contracts could not be seen independently. The dominant purpose or intention of the buyer from the very beginning was installation of multilayer packaging coated board plant under the supervision of the assessee. As the assessee was also specialised in manufacturing of equipment required for setting up of the plant, the assessee was involved in supply of the equipment. The plant in itself was not a set of machinery only but the contractor was required to construct a facility of manufacturing the products of the buyer. The various machines supplied were components of the plant to be constructed or erected under the supervision of the assessee. These goods in themselves were components of plant, which had been delivered by the assessee. The intention of the parties was to provide to the buyer a plant in deliverable state. The final acceptance of the supply of goods was dependent on the success of performance warranty test. The service contract had a provision of termination clause in case of failure of performance and return of machinery supplied under the supply contract and refund of money. All these terms made it clear that both the supply and service contract were intrinsically linked and not severable. It was not possible for the buyer to assemble or erect the plant from any other contractor without the supervision of the assessee*

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and therefore the buyer made its intention of getting the goods in a deliverable state. The division of the composite contract into supply and service on paper was artificial and the conduct of the parties and terms and condition of the contract manifested that in substance it was a composite contract. The accounting practice followed for recognising of revenue from service on completion of the project also supported the intention of the parties to treat the erection of the plant as a composite project. Thus, the supply and service contracts represented a single, composite turnkey works contract.

SHANGHAI ELECTRIC GROUP CO. LTD. *v.* DY. CIT (I. T. A. Nos. 224 to 227/Delhi/2015 dated July 14, 2017), INDURE LTD. *v.* CTO [2010] 34 VST 509 (SC), LARSEN AND TOUBRO LTD. v. STATE OF A. P. [2016] 88 VST 422 (T&AP) *and* CIT *v.* MITSUI ENGINEERING AND SHIP BUILDING CO. LTD. [2003] 259 ITR 248 (Delhi) *followed*.

ISHIKAWAJIMA-HARIMA HEAVY INDUSTRIES LTD. *v.* DIT [2007] 288 ITR 408 (SC) *distinguished*.

(ii) That the assessee had supplied parts of goods under invoices and the goods had further been assembled in India to bring them in deliverable state as agreed in the supply agreement between the assessee and the buyer and thus property in goods had passed in India and thus part of the consideration of the supply agreement for offshore supply was taxable in India. No information had been provided by the assessee in respect of the activity carried out in India subsequent to award of the tender to the assessee for collection of drawings of the factories of the buyer and other input information in relation to erection of the plant and customised manufacturing of the parts of various sections of the plant.

(iii) That since part of the operations of the supply agreement had been carried out in India and sale of goods was in continuation of the process of erection of the plant, a business connection existed. There was an element of continuity between the business of the assessee from supply to successful supervision of the commission of plant. It was not a case of isolated sale of off-the-self goods or stray transaction, in view of the fact that the assessee had rendered supervision of erection or commission of the plant. Thus, the business activities in India were not isolated instances but represented real and intimate relationship between activities of the assessee done outside India and those done inside India. The business operations in India were revenue generating as these operations were required to earn the contract and to meet the contractual obligations. Therefore, all parameters of business connection were satisfied in the case of the assessee. Accordingly, the income was deemed

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to accrue or arise in India in terms of section 9(1)(i) from the offshore supply of goods.

(iv) That in addition to the marketing activities or engineering survey pre or post-awarding of contract for which no information had been filed by the assessee the service permanent establishment had played a role in assembling and bringing the equipment to a deliverable state as agreed under the supply agreement. In such facts and circumstances 35 per cent. of the profits could be attributed to the permanent establishment.

(v) That the assessee had accepted the existence of the permanent establishment before the Assessing Officer and it could not contend that it was the responsibility of the deductor to deduct tax at source. Thus, the assessee was liable for interest under section 234B.

Cases referred to :

Anglo-French Textile Co Ltd. *v.* CIT [1954] 25 ITR 27 (SC) (para 10)

Anglo French Textile Company Ltd. *v.* CIT [1953] 23 ITR 101 (SC) (para 10)

Annamalais Timber Trust and Co. *v.* CIT [1961] 41 ITR 781 (Mad) (para 10)

Asia Satellite Telecommunications Co. Ltd. *v.* DIT [2011] 238 CTR 233 (Delhi) (para 11)

Baker Hughes Asia Pacific Ltd. *v.* Addl. DIT (I. T.) [2014] 34 ITR (Trib) 192 (Delhi) (para 6)

Bellsea Ltd. *v.* Asst. DIT (I. T.) [2018] 66 ITR (Trib) (S.N.) 29 (Delhi) (para 9)

Bharat Sanchar Nigam Ltd. *v.* Union of India [2006] 282 ITR 273 (SC) (para 5)

Calcutta Jute Manufacturing Co. *v.* CTO [1997] 106 STC 433 (SC) (para 11)

Cape Brandy Syndicate *v.* IRC [1921] 1 KB 64 (para 11)

Central Province Manganese Ore Co. Ltd. *v.* CIT [1986] 160 ITR 961 (SC) (para 11)

Commissioner of Commercial Tax (Dy.) *v.* A. R. S. Thirumeninatha Nadar Firm [1968] 21 STC 184 (Mad) (para 7)

CIT *v.* Ahmedbhai Umarbhai and Co. [1950] 18 ITR 472 (SC) (para 10)

CIT *v.* Ajax Products Ltd. [1965] 55 ITR 741 (SC) (para 11)

CIT *v.* Atlas Steel Co. Ltd. [1987] 164 ITR 401 (Cal) (para 8)

CIT *v.* Bertrams Scott Ltd. [1987] 31 Taxman 444 (Cal) (para 10)

CIT *v.* Chandra Sekhar (M.) [1985] 151 ITR 433 (SC) (para 11)

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CIT *v.* Gotla (J. H.) [1985] 156 ITR 323 (SC) (para 11)

CIT *v.* Gulf Oil (Great Britain) Ltd. [1977] 108 ITR 874 (Bom) (para 8)

CIT *v.* Hindustan Shipyard Ltd. [1977] 109 ITR 158 (AP) (para 8)

CIT *v.* Hyundai Heavy Industries Co. Ltd. [2007] 291 ITR 482 (SC) (paras 1, 6, 9)

CIT *v.* Mitsui Engineering and Ship Building Co. Ltd. [2003] 259 ITR 248 (Delhi) (paras 2, 4, 5)

CIT *v.* Neyveli Lignite Corporation Ltd. [2000] 243 ITR 459 (Mad) (para 5)

CIT *v.* R. D. Aggarwal and Co. [1965] 56 ITR 20 (SC) (paras 2, 8)

CIT (Addl.) *v.* Skoda Exports, Praha [1988] 172 ITR 358 (AP) (para 7)

Convergys Customer Management Group Inc. *v.* Asst. DIT (I.T.) [2013] 26 ITR (Trib) 443 (Delhi) (para 10)

DIT (IT) *v.* Alcatel Lucent USA Inc. [2014] 2 ITR-OL 276 (Delhi) (paras 1, 11)

DIT (IT) *v.* Alcatel Lucent World Services Inc. [2014] 2 ITR-OL 276 (Delhi) (paras 1, 11)

DIT *v.* E-Funds IT Solution [2014] 364 ITR 256 (Delhi) (para 9)

DIT (Asst.) *v.* E-Funds IT Solution Inc [2017] 399 ITR 34 (SC) (para 9)

DIT *v.* Ericsson A. B. [2012] 343 ITR 470 (Delhi) (para 6)

DIT *v.* Ericsson A. B. [2017-TII-119-ITAT-Delhi-INTL] (para 7)

DIT (IT) *v.* GE Packaged Power Inc. [2015] 373 ITR 65 (Delhi) (para 11)

DIT (IT) *v.* Hyosung Corporation (W. P. (C) No. 2765 of 2010 and C.M. No. 5515 of 2010—Delhi, dated March 25, 2011) (para 6)

DIT *v.* Jacabs Civil Incorporated [2011] 330 ITR 578 (Delhi) (para 11)

DIT *v.* LS Cable Ltd. [2016] 243 Taxman 427 (Delhi) (para 9)

DIT *v.* LG Cable Ltd. [2011] 237 CTR 438 (Delhi) ; [2011] 197 Taxman 51 (Delhi) (paras 6, 7)

DIT *v.* Maersk Co. Ltd. [2011] 334 ITR 79 (Uttarakhand) (para 11)

DIT *v.* Mitsubishi Corporation [2011] 330 ITR 578 (Delhi) (para 11)

DIT *v.* Nokia Networks OY [2013] 358 ITR 259 (Delhi) (para 6)

Formula One World Championship Ltd. *v.* CIT (IT) [2017] 394 ITR 80 (SC) (para 9)

Galileo International Inc. *v.* Dy. CIT [2008] 19 SOT 257 (Delhi) (para 9)

G. V. K. Industries Ltd. *v.* ITO [1997] 228 ITR 564 (AP) (para 2)

GE Energy Parts [2019-TII-01-HC-Delhi-INTL] (para 9)

Hindustan Shipyard Ltd. *v.* State of Andhra Pradesh [2000] 119 STC 533 (SC) (paras 1, 2, 4, 5)

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Hukum Chand Mills Ltd. *v.* CIT [1976] 103 ITR 548 (SC) (para 10)

Hyosung Corporation, *In re* [2009] 314 ITR 343 (AAR) (paras 6, 7)

Indure Ltd. *v.* Commercial Tax Officer [2010] 34 VST 509 (SC) (para 5)

Ishikawajima-Harima Heavy Industries Ltd. *v.* DIT [2007] 288 ITR 408 (SC) (paras 1, 4, 6)

Jodha Mal Kuthiala (R. B.) *v.* CIT [1971] 82 ITR 570 (SC) (para 11)

Larsen and Toubro Ltd. v. State of A. P. [2016] 88 VST 422 (T&AP) ; [2015-TIOL-3055-HC-AP-CT] (para 6)

LS Cable Ltd., *In re* [2011] 337 ITR 35 (AAR) (para 9)

Mahabir Commercial Co. Ltd. *v.* CIT [1972] 86 ITR 417 (SC) (para 6)

Motorola Inc. *v.* Dy. CIT [2005] 95 ITD 269 (Delhi) [SB] (paras 6, 7, 9, 10)

National Petroleum Construction Co. *v.* DIT (IT) [2016] 383 ITR 648 (Delhi) (para 9)

Nokia Networks OY *v.* Jt. CIT [2018] 65 ITR (Trib) 23 (Delhi) (para 6)

Rheinbraun Engineering and Wasser GmbH [1915/Bom/96] (para 11)

Rolls Royce Plc *v.* DIT (IT) [2011] 339 ITR 147 (Delhi) (paras 2, 10)

Roxar Maximum Reservoir Performance WLL, *In re* [2012] 349 ITR 189 (AAR) (para 5)

Samsung Heavy Industries Co. Ltd. *v.* DIT [2017] 10 ITR-OL 673 (Uttarakhand) (para 10)

Sedco Forex International Drilling Inc *v.* Dy. CIT [2000] 72 ITD 415 (Delhi) (para 11)

Seth Pushalal Mansinghka (P.) Ltd *v.* CWT [1967] 66 ITR 159 (SC) (para 6)

Shangahai Electronics Group Company Ltd. [2017-TII-119-ITAT-DEL-INTL] (para 7)

Shanghai Electric Group Co. Ltd. *v.* Dy. CIT [2018] 10 ITR (Trib)-OL 339 (Delhi) (para 5)

Skoda Export *v.* Addl. CIT [2003-TII-34-HC-AP-INTL] (para 6)

State of Gujarat *v.* Chem-Dyes Corporation [1991] 83 STC 488 (Guj) (para 7)

State of Karnataka *v.* Bangalore Soft Drinks P. Ltd. [2000] 117 STC 413 (SC) (para 5)

State of Madras *v.* Gannon Dunkerley and Co. (Madras) Ltd. [1958] 9 STC 353 (SC) (para 5)

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State of Tamil Nadu *v.* Kandaswami (M. K.) [1975] AIR 1975 SC 1871 (para 11)

Tata Iron and Steel Co. Ltd. *v.* Sarkar (S. R.) [1960] 11 STC 655 (SC) (para 7)

U. A. E. Exchange Centre Ltd. *v.* Union of India [2009] 313 ITR 94 (Delhi) (para 9)

UAE Exchange Centre LLC, *In re* [2004] 268 ITR 9 (AAR) (para 9)

Usha Beltron Ltd. *v.* State of Punjab [2005] 7 SCC 58 (paras 6, 7)

Van Oord Atlanta B. V. *v.* Asst. DIT [2007] 112 TTJ 229 (Kol) (para 9)

I. T. A. No. 1077/Delhi/2014 (assessment year 2010-11).

Ajay Vohra, Senior Advocate and *Akshay Uppal*, Chartered Accountant, for the assessee.

G. K. Dhall, Commissioner of Income-tax (Departmental representative) (International Taxation), for the Department.

ORDER

The order of the Bench was pronounced by

O. P. KANT ***(Accountant Member)***.—The assessee has preferred this appeal against the final assessment order dated January 2, 2014, passed by the Deputy Director of Income-tax, Circle-2(2), International Taxation, New Delhi (in short, "the Ld. AO"), in pursuant to the direction dated December 27, 2013 of the learned Dispute Resolution Panel (DRP). The grounds raised in the appeal are reproduced as under : 1

> "1. That in the facts and in the circumstances of the case and in law, the order of the Deputy Director of Income-tax (International Taxation), Delhi (Assessing Officer) under section 143(3) in pursuance of the direction issued under section 144C by the Dispute Resolution Panel (DRP) is perverse, bad in law and void, being contrary to law and the principles of natural justice.
>
> 2. That the learned Assessing Officer has erred in computing the income at Rs. 16,14,04,346 as against the returned income of Rs. nil.
>
> 3.(a) That the learned Assessing Officer and the Dispute Resolution Panel have erred in law and on facts in holding that an income of Rs. 16,14,04,346 in relation to contract for supply of equipment, is deemed to accrue or arise in India under section 9(1)(i) of the Indian Income-tax Act ('the Act') and consequently is taxable in India in terms of section 5(2) of the Act.
>
> (b) That the learned Assessing Officer/Dispute Resolution Panel has erred on facts and in law in holding that sale of equipment was

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concluded in India based on the incorrect interpretation of terms and conditions of contract in respect of supply of equipment.

(c) That the learned Assessing Officer/Dispute Resolution Panel has misdirected themselves in holding the supply and service contracts in the nature of composite contract and also that the activities have been dissected for the purpose of tax avoidance.

(d) That the learned Assessing Officer/Dispute Resolution Panel has erroneously held that the relevant two contracts were in the nature of non-divisible 'works contract' and erroneously relied on the decision of *Hindustan Shipyard Ltd.* v. *State of Andhra Pradesh* [2000] 119 STC 533 (SC) ; [2000] 6 SCC 579, not applicable on facts and in law.

(e) That the learned Assessing Officer/Dispute Resolution Panel has made erroneous observations, assumptions of facts, in coming to the conclusion that the business activities carried out by the service (deemed) permanent establishment of the appellant in India contributed to the earning of profits earned by the appellant from offshore supply of equipment without appreciating that all the equipment were manufactured and supplied from outside India and the service permanent establishment had no role to play in the same.

(f) That the learned Assessing Officer/Dispute Resolution Panel has grossly erred in law and on facts that consideration for sale of plant and equipment was liable to tax in India on incorrect appreciation of the provisions of supply contract, wrong interpretation of the provisions of the Act and the Double Taxation Avoidance Agreement between India and Austria.

(g) That the learned Assessing Officer and the Dispute Resolution Panel have misdirected themselves on wrong assumptions of facts and in law in not accepting the claim that the supply of equipment represented consideration of the nature of 'business profits' not liable to tax in India, as per the provisions of the Double Taxation Avoidance Agreement between India and Austria read with the Act.

(h) That the learned Assessing Officer and the Dispute Resolution Panel have grossly erred in holding that the assessee had a project office/branch office in India which constituted a permanent establishment.

(i) That the learned Assessing Officer and Dispute Resolution Panel have grossly erred in stating that alleged permanent establishment was involved in marketing activity in India without any basis.

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(j) That the decisions as relied upon by the learned Assessing Officer are distinguishable, not applicable, on facts of the assessee.

(k) That the learned Assessing Officer/Dispute Resolution Panel has erred in not following the decisions of the hon'ble Supreme Court of India and the jurisdictional High Court in the following cases where, on similar facts, it has been held that consideration for supply of plant and equipment, from outside India, was not liable to tax in India.

(i) *CIT* v. *Hyundai Heavy Industries Co. Ltd.* [2007] 291 ITR 482 (SC) ;

(ii) *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* [2007] 288 ITR 408 (SC).

(iii) *DIT* v. *LG Cables Ltd.* [2011] 197 Taxman 51 (Delhi).

(l) That the learned Assessing Officer/Dispute Resolution Panel has wrongly and without any basis erred in holding that the assessee has a business connection and 'fixed place of business' in India where from business of the assessee was wholly or partly carried on.

(m) That the learned Assessing Officer/Dispute Resolution Panel has erred in holding that the assessee had a fixed place permanent establishment by erroneously linking it Thyssen Krupp companies belonging to a different group.

(n) That without prejudice, the learned Assessing Officer/Dispute Resolution Panel has erred in applying the FAR analysis and benchmarking of uncomparable companies in computing profit attributable in India in relation to supply of equipment at Rs. 16,14,04,346 and failed to appreciate that global income statement or appellant was also submitted. That attribution of profits, as made, on such benchmarking by the learned Assessing Officer, without providing details to the assessee, is totally unjustified and illegal and also fail to consider the result of the global accounts of the assessee.

(o) Without prejudice, the learned Assessing Officer/Dispute Resolution Panel has erroneously held that on facts, profit attributable in respect of supplies is 35 per cent. of the profit accruing from offshore supplies. The said attribution is arbitrary, highly excessive and has no rationale whatsoever, and is against the principles of attribution as laid down under the provisions of the Income-tax Act, the Double Taxation Avoidance Agreement between India and Austria and various decisions of the hon'ble High Court, the Supreme Court of India. Reliance made on the decision of the hon'ble Delhi High Court in the

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case of *Rolls Royce* is unjustified as the same is not applicable on the facts of the assessee.

(p) Without prejudice, the computation of revenue regarding the offshore supply of equipment has been erroneously made as the rate of exchange for conversion into rupees of income expressed in foreign currency has been taken arbitrarily and not as per rule 115 of the Income-tax Rules.

4. That the learned Assessing Officer/Dispute Resolution Panel has erred in directing the charging of interest under sections 234A, 234B and 234D as the same is not attracted on facts. Reliance made by the learned Assessing Officer/Dispute Resolution Panel on decision of *DIT (IT)* v. *Alcatel Lucent USA Inc.* (I. T. A. Nos. 327, 338 and 339 of 2012) and *DIT (IT)* v. *Alcatel Lucent World Services Inc.* (I. T. A. Nos. 326, 329 and 336 of 2012) [2014] 2 ITR-OL 276 (Delhi) is not justified, as the same is not applicable on facts.

5. That the learned Assessing Officer has erred in initiating penalty proceedings under section 271(1)(c) of the Income-tax Act, 1961, the provisions of which are not attracted on the facts.

6. That the assessee may be allowed to add, supplement, revise, amend the grounds as raised hereinabove."

2 Briefly stated facts of the case are that the assessee, M/s. Voith Paper GmbH (in short, the "Voith") is a company incorporated under the laws of the Austria, having it registered office at Linzer 55, A-3100 St. Poeltran, Austria. The assessee-company is one of the market leaders in concept, technology, project planning, sale, engineering, processing, sourcing and marketing of "board and packaging paper machines".

2.1 For the year under consideration, the assessee filed return of income on March 28, 2012 declaring nil income in the status of a non-resident Indian (NRI). In the return of income filed, the assessee declared its address as C/o Mohinder Puri and Co. 1A-D Vandana Building 11, Tolstoy Marg, New Delhi.

2.2 The assessee had entered into two contracts on June 19, 2008 with the "Century Pulp and Paper Company" (CPPC), a division of M/s. Century Textile Industries Ltd. for equipment supply and service for commissioning of "620 TPD" multilayer packaging coated board plant. The supply included for engineering, designing, manufacturing, drawing and supplying of machinery for 620 TPD multilayer packaging coated board plant and service included for supervision of erection, start up, training, commissioning and performance test of the said machinery.

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2.3 During the scrutiny assessment proceedings for the year under consideration, the assessee provided details of both the contracts of equipment "supply" and "service" contracts. The summary of the contract price of equipment "supply" and "service" contract, reproduced by the Assessing Officer in the impugned order is extracted as under :

SUMMARY OF SUPPLY CONTRACT PRICE INVOICED ON THE CUSTOMER

S. No.	*Year*	*Offshore supply of equipment*	*Drawing and deigning*
		Euro	*Euro*
1.	AY 2010-11 (FY 2009-10)	67,481,776	Nil
2.	AY 2011-12 (FY 2010-11)	1,017,024	Nil
	Total	68,498,600	Nil

SUMMARY OF SERVICE CONTRACT PRICE RECEIVED FROM THE CUSTOMER

S. No.	*Year*	*Payment received (net of taxes)*		*Payment (Grossed up*	*Received @10%)*
		Euro	*INR*	*Euro*	*INR*
1.	AY 2010-11 (FY 2009-10)	59,400	3,631,260	66,000	4,034,734
2.	AY 2011-12 (FY 2010-11)	1,889,400	114,953,535	2,099,033	127,726,150
3.	AY 2012-13 (FY 2011-12)	1,496,400	96,042,812	1,662,667	106,714,236
	Total	3,445,200	214,627,608	3,828,000	238,475,120

2.4 The assessee has supplied the machinery parts in the financial year 2009-10 (relevant to assessment year under consideration) and subsequent financial year. During the year under consideration, the assessee raised invoices for supply of components of machinery from September 14, 2009 to December 9, 2009 and shipped the containers through sea. The personnel of the assessee-company visited from December 14, 2009 to March 31, 2010 for supervision of the erection, start up, training, commissioning and performance test of the TPD plant.

2.5 It was contended by the assessee that the income in respect of "offshore supply" of equipment was not taxable as per the provisions of the Income-tax Act, 1961 (in short, "the Act") as well as under the Double Tax Avoidance Agreement (DTAA) between India and Austria. The assessee submitted that it had no fixed place of business in India as per article 5(2) of the Double Taxation Avoidance Agreement between India and Austria as far as offshore supply of machinery was concerned.

2.6 Regarding the service contract, it was submitted that during the year under consideration, the assessee was engaged in undertaking super-

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vision of erection in relation to machines supplied by the assessee from outside India, which is an activity incidental to the plant and for execution outside activities, for which the assessee deputed its personal from time to time. Such service activities in relation to the machine, were continued for a period exceeding six months and thus by virtue of the provision of article 5(2)(i) of the Double Taxation Avoidance Agreement between India and Austria, only in respect of the said service activity, the assessee had a deemed permanent establishment (PE) in India.

2.7 The assessee declared income in respect of supervision activity for taxation on the receipt basis following the completed contract method (CCM). Under the completed contract method, the amount received from the customer and the costs incurred in respect of supervision activity during the year was carried over to the next financial year(s) till the project activity was completed. In the financial year in which the installation activity was completed, all the amounts invoiced on the customer are brought forward as income to the profit and loss account and similarly all the costs and expenses brought forward from earlier year(s) are transferred to the profit and loss account for the purpose of determining the net profit and net tax payable by the assessee.

2.8 During assessment proceedings, the learned Assessing Officer examined the contracts agreements and found that both contracts of supply and service constituted as composite contract. According to the learned Assessing Officer (AO), in view of business connection, the part of the income from offshore supply of machinery was deemed to accrue or arise in India and hence taxable under section 9(1) of the Act. The Assessing Officer was of the view that the said part of income from offshore supply of machinery, was also taxable in India in terms of the Double Taxation Avoidance Agreement between India and Austria. The Assessing Officer issued a show-cause notice to the assessee that it had a permanent establishment (PE) in India, in the form of project office and as per article 7(1) of the Double Taxation Avoidance Agreement between India and Austria, the profits of the enterprise attributable to the permanent establishment in India would be taxable in India. The Assessing Officer computed the supply of machinery during the year at Rs. 472,97,97,680 and in the show cause, he proposed that in offshore supplies segment, the role of permanent establishment was akin to distribution function, i. e., the permanent establishment has first purchased the equipment/platform from the head office (HO) and then sold to Indian customer. According to the Assessing Officer, the transaction of such purchase by and transfer of equipment to the "permanent establishment" was international transaction, which was

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not reported by the assessee for transfer pricing adjustment. The Assessing Officer carried out benchmarking of distribution function of the "permanent establishment" and based on set of comparables, computed average margin for "distribution services" at 9.75 percentile. Accordingly, he proposed profit mark-up at average margin of 9.75 per cent. on supply of Rs. 472,97,97,680 which amounted to Rs. 46,11,55,273.

2.9 The assessee objected for considering the taxability of profit from supply of machineries made from outside India, as according to the assessee sale of machinery was made outside India and the payment was also received outside India and thus no part of offshore supply was taxable in India. In support of the claim, the assessee relied on various judicial pronouncements.

2.10 After considering the submission of the assessee, the Assessing Officer made the factual observation about the activities of the assessee in para 8 of the assessment order, which is extracted as under for ready reference :

1. The assessee has entered into a contract with Century Pulp and Paper Company for supply of paper machine and undertaking supervision of erection, start up training commissioning and performance services.

2. There is offshore supply and supervision services.

3. From the perusal of scope of activities, it is seen that the assessee was carrying out all the drawings, design and engineering along with supervision of erection, commissioning, etc., of the TPD plant.

4. From the scope of activities it is clear that that the activities are of the nature of composite contract activity but the activities have been dissected just for the purpose of tax avoidance.

5. The situs of work is in India and the objective of composite nature of work is to provide the goods in deliverable state to Century Pulp and Paper Company.

6. Offshore supplies are integral part of supervision of final commissioning and installation of the TPD plant.

7. During the year there is offshore supplies amounting to Rs. 472,97,97,680.

2.11 According to the Assessing Officer, supply cannot be termed as contract for sale of equipment because machineries though manufactured in Austria but were required for manufacturing and commission of the TPD plant in India. The Assessing Officer relied on the decision of the hon'ble Supreme Court in the case of *Hindustan Shipyard Ltd.* [2000] 119 STC 533 (SC) ; [2000] 6 SCC 579 and concluded that the contract of supply and ser-

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vice in relation to commission of the TPD plant is a composite contract. The finding of the Assessing Officer in relation to "composite contract" are reproduced as under :

> "11. I have examined the facts of this case along with the ratio decidendi abovereferred to the judgment of the hon'ble Supreme Court and have noted that the dictum of law for the second category of contract (ii) as discussed above is squarely applicable to the identical facts of the case under consideration. In this case, the assessee had entered into a contract with Century Pulp and Paper Company to design, build, manufacture, supply, installation, testing and commission of machinery for the TPD plant. The supply of machines was necessary and incidental to design, manufacture, installation, testing and commission of above facility, i. e., machinery for the TPD plant in India. It is not the case of the assessee that the contract was signed for supply of machines only and some technical work was required to be done as incidental to machines only and some technical work was required to be done as incidental to sale of equipment. Even though the assessee during the assessment proceedings, mentioned that the supply of machinery for the TPD plant and the installation and commissioning services are separate and independent of each other, a careful perusal of this document reveal that as per the terms and conditions of the contract the effective mandate given to the assessee is in the nature of composite contract . The purpose and intention of Century Pulp and Paper Company was to install a fully functional machinery for the TPD plant in working condition at the airport and the assessee-company was given this responsibility. Therefore, respectfully following the above principle as laid down by the hon'ble apex court, I am of the considered view that the impugned contract is nothing but a consolidated contract was for design, build, manufacture, supply, installation, testing and commissioning, of machinery for the TPD plant, i. e., works contract and the contract cannot be subdivided as contract for sale of equipment and contract for technical services as was wrongly been argued on behalf of the assessee.
>
> 11.1 In this case designing, manufacturing, commissioning and calibration of abovereferred to machinery for the TPD plant was complete responsibility of the assessee-company which was only one contractor to implement the contract and it had furnished performance guarantee and guarantee for timely completion of the project of building and commissioning these machinery for the TPD plant. It is not a case where separate contract were signed by different parties

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to execute a project. The hon'ble Supreme Court in the case of *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* (supra) examining the contract for sale and services has held as under (page 433 of 288 ITR) :

'We do not think that these observations furnish a universal test that whenever there is a contract to "fix" certain articles made by a manufacturer the contract must be deemed one for sale and not of service. The test in each case is whether the object of the party sought to be taxed is that the chattel as chattel passes to the other party and the service rendered in connection with the installation are under a separate contract or are incidental to the execution of the contract of sale.'

12. I have examined the facts of the case in the light of the above referred to the ratio decidendi as laid down by the hon'ble apex court and I have noted that in this case the assessee had not rendered services to fix certain article or equipment but in this case equipment (machinery for the TPD plant) and spares were required to design, build manufacture, commission, calibrate and operation of above referred to machinery for the TPD plant. These equipment were part of machinery for the TPD plant. In view of these facts it is held that it is the works contract and the same cannot be held and divided as contract for sale of equipment.

13. The peculiar facts of this case is covered in favour of the Department by the judgment of the hon'ble jurisdictional High Court in the case of *CIT* v. *Mitsui Engineering and Ship Building Co. Ltd.* [2003] 259 ITR 248 (Delhi) wherein the contention was that the finding that the contract for designing, engineering, manufacturing, shop testing and packing up to FOB port of embarkation could not be split up since the entire contract was to be read together and was for one complete transaction. It was in the said fact situation held that it was not possible to apportion the consideration for design on one part and the other activities on the other part. The price paid to the assessee was the total contract price which covered all the stages involved in the supply of machinery. In construing a contract, the terms and conditions thereof are to be read as a whole. A contract must be construed keeping in view the intention of the parties. In this case the intention of the assessee was to design, built, manufacture, commission, calibrate and operation of 'machinery for the TPD plant' not the sale of trade items. In this context that these contracts under consideration are composite contract which could not be splitted to

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> demonstrate FOB sale of equipment as separate activity respectfully following the ratio decidendi of cited authority I am of the considered view that these contracts cannot be splitted to hold that sale of spares and equipment needed for commissioning of these repair facility was a separate contract for sale."

2.12 Thereafter, the Assessing Officer went on to hold that income from the composite contract was taxable under section 9(1) of the Indian Income-tax Act as the income deemed to accrue or arise in India through or from the business connection in India. In view of the decision of the hon'ble Supreme Court in the case of *CIT* v. *R. D. Aggarwal and Co.* [1965] 56 ITR 20 (SC), and the decision of the hon'ble Andhra Pradesh High Court in the case of *G. V. K. Industries Ltd.* v. *ITO* [1997] 228 ITR 564 (AP), he summarised the essential of "business connection" as under :

> (i) a real and intimate relation must exist between the trading or other business activities by a non-resident carried on outside India and the activities within India ;
>
> (ii) the relation contributes directly or indirectly to the earning of income by the non-resident in his business ; a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of business connection.

2.13 In view of the facts and circumstances of the case, the Assessing Officer concluded the taxability under the Indian Income-tax Act as under :

> "17. In the light of the abovestated dictum of law, I have examined the facts of the case and have noted that in this case, the assessee had business connection in India in the year under consideration for earning income from supply of the TPD plant and supervisory services. In this case the business of the assessee was to design, build, manufacture, supply and supervision of installation, testing and commissioning of 'machinery for the TPD plant' for Indian customer (CPPC). The assessee had carried out the business activities in India through its deemed permanent establishment in India and these activities had contributed in earning of the profit by the assessee both on account of supervisory services and supplies of equipment needed for the TPD plant. These facts have proved beyond doubts that there was a real and intimate relationship on continuous basis between the business activities carried on in India and the business of the assessee who is a non-resident and this relationship had resulted in accrual of income to the assessee both on providing supervisory services and supplies of

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design, drawing and equipment to Indian customer. It is proved from above discussion that all the three essential features of the business connection mentioned above are present in this case. Therefore, the income accruing or arising to the assessee by way of profit from design, manufacture, supply of machines, supervision of installation, testing and commissioning of machinery for the TPD plant to Indian customer shall be deemed to accrue or arrive in India under section 9(1)(i) of the Act and consequently the same is taxable in India under domestic law in terms of section 5(2) of the Act."

2.14 The Assessing Officer also held the existence of the permanent establishment in India and taxability under the Double Taxation Avoidance Agreement between India and Austria. The Double Taxation Avoidance Agreement has defined the permanent establishment as a fixed place of business through which the business of an enterprise is wholly or partly carries out. The existence of deemed permanent establishment in respect of supervision activities has not been disputed by the assessee in view of employees of the assessee were stationed at the Century Pulp and Paper Company TPD plant in the year under consideration for supervising the erection and commissioning of the TPD plant. The Assessing Officer is of the view that the address mentioned in the return of income was at the disposal of the assessee for a very long duration and it was involved in marketing and pre-contract negotiations done by the assessee, and thus, permanent establishment of the assessee existed from the beginning of the supply contract. The relevant finding of the Assessing Officer is reproduced as under :

"18.2 Further, in the tax audit report furnished in form 3CB and form 3CD under rule 6G(1)(b) of the Income-tax Rules, 1962 of the assessee (related to the permanent establishment in India for the contract with Ford India Pvt. Ltd.,the address of the permanent establishment is mentioned as 'Mohinder Puri and Co 1A-D, Vandhna Building 11, Tolstoy Marg, New Delhi-110 001. In the return of Income filed by the assessee also the same address is mentioned as the address of the assessee. Also, the undersigned is also the Assessing Officer of other group companies of the assessee (M/s. Thyssen Krupp Elevator Australia Pty. Limited and M/s. ThyssenKrupp Airport System SA). Both these companies have branch office/project office at the same address as given by the assessee. Therefore, there can be no dispute on the fact that this address is a place of business and this place of business is at the disposal of the assessee. Next let us examine whether any business activity is carried out from or through this

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place of business. In form 3CD mentioned above in column No. 9(b) it is mentioned that the books of account of the permanent establishment are maintained in the computer system. In form 3CD and 3CB supra the address of the assessee is at supra. Therefore there is no reason to presume that the computer system mentioned supra is not installed at the address of the assessee. Maintenance of books of account is a core business activity which is carried out from the abovementioned place of business. The returns of the assessee are being filed in India since last many years and in all the returns the address of the assessee remains the same. Therefore it is implied that this place of business is at the disposal of the assessee for sufficiently Iona duration to be called as 'permanent establishment'. Therefore, the assessee's submission that the permanent establishment came into existence after the supply under the impugned contract is completed, is not correct. In fact the permanent establishment was very much involved in the marketing and pre-contract negotiations done by the assessee.

18.3 It is evident from the abovereferred to the facts that the assessee had carried out the business of design, manufacture, supply and supervision of installation, testing and commissioning of machinery for the TPD plant from the permanent establishment of the assessee in India. The supplies of machinery for the TPD plant were a part of a composite contract. Accordingly, a part of the profit earned by the assessee on supply was attributable to fixed place of permanent establishment of the assessee in India."

2.15 The Assessing Officer also rejected the contention of the assessee that the machinery for the TPD plant were delivered outside India and thus no profit from offshore supply could be attributed to the permanent establishment of the assessee, observing as under :

"18.4 The claim of the assessee that the machinery for the TPD plant were delivered outside India in Austria, accordingly no profit from offshore supply could be attributed to the permanent establishment of the assessee in India. I have carefully examined the terms and conditions of the agreement and have noted that the claim of the assessee is factually incorrect. As per the terms and conditions of the agreement the assessee has to deliver the machinery for the TPD plant in running condition after completing supervision of the installation, commissioning and testing. In such a condition the assessee's contention that the equipment are sold to Century Pulp and Paper Company in high seas cannot be anything but a tax avoidance

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scheme. When the assessee is required to have possession of the goods at the work site for supervision of installation, the passing of possession in high seas to Century Pulp and Paper Company and again taking it back at the site is highly illogical. No purpose other than tax evasion can be served from this transaction. Further, there is no documentary evidence also of the receipt of these goods by the assessee or its agent at the work site. Even as per section 19(1) of Sale of Goods Act the title of goods passes when the contracting parties intend it to pass. In this case, when the intention of one of the contracting parties (Century Pulp and Paper Company) is to receive the goods in a working condition, the mere documents stating that the title has passed overseas have no value as the nature of goods in this case is such which cannot be imagined to be in working condition high seas. Both these facts are contradicting each other therefore, only one of them can be fact. Since the other clauses of the impugned contract are in operation, the title over the goods cannot pass overseas."

2.16 The Assessing Officer also examined the claim of the assessee that the title of the machinery supplied passed outside India in the light of the Sale of Goods Act, 1930 (in short, "the SGA"). The Assessing Officer referred to section 19(1) of the Sale of Goods Act which provides that in a contract for sale of goods, the property is transferred to the buyer at such time as the parties to the contract intend it to be transferred. Section 19(2) of the Sale of Goods Act provides as intention of the parties has to ascertain from the terms of contract, the conduct of parties, the circumstances of the case. The Assessing Officer after examining the circumstances provided in section 19(2) of the Sale of Goods Act held that the parties intended to pass title of the equipment in India only. The observations of the Assessing Officer are reproduced as under :

"Section 19(1) of the Sale of Goods Act provides in a contract for the sale of goods, the property is transferred to a buyer at such time as the parties to the contract intend it to be transferred. However, section 19(2) of the Act provides that for the purpose of ascertaining the intention of the parties, regard shall be had to :

(a) the terms of the contract ;

(b) the conduct of the parties ; and

(c) the circumstances of the case.

(b) The contract has to be read as a whole to ascertain the intention of the parties.

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(c) The definition of these terms clearly indicates that the entire risk is borne by the supplier and carriage and insurance charges paid till their delivery at airport/seaport in India. The repeated reference by the assessee to Incoterms 2000 does not alter the situation because the expression by its very definition in the agreement means the obligation to bear the carriage and insurance charges up to airport/seaport in India. It would be illogical to read that the parties particularly Century Pulp and Paper Company in India, can agree to the delivery at any airport/seaport outside India.

19.2 In view of all the abovereferred to clauses, if the agreement is read as a whole, the intent of the parties is clear that the title to the equipment passes in India at the site where the deliveries are made or in a worst scenario at the airports/seaports in India.

19.3 Under the normal circumstances, the risk and title would go together. In the present case, the terms of the agreement read as a whole and the conduct of the parties go to indicate that the documents submitted by the assessee during the course of assessment like bill of lading, invoices, import documents, etc., do not demonstrate the true intent of the parties. This condition of the supply cannot be met it. The goods are delivered on high seas The "full satisfaction" can be reached only in India after the provisional acceptance. One cannot pick up one part of supply obligation and contend that the title has passed with the discharge of that obligation. Incoterms 2000 only refer to the terms of the agreement generally acceptable between the contracting parties with regard to obligation to bear the cost of transportation, insurance till the point of delivery. Thus, if the agreement is viewed as a whole, it demonstrates that the supplier has the obligation to deliver the goods at the relevant site in India and the documents showing that the title passes in high seas does not reflect the actual mode and delivery of the supply nor the true intent of the parties. Section 19(2) of the Sale of Goods Act provides for the factors to determine the intent of the parties and if despite the declaration to the contrary under section 19(1), if it is found as a matter of fact that the deliveries had been made in India it would be open to the Revenue to assert that title to the goods had passed in India."

2.17 The Assessing Officer further referred to section 21 of the Sale of Goods Act, which provides that where there is a contract for sale of specified goods and seller is bound to do something to the goods for the purpose of putting them in a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. The Assessing Officer

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observed that in the instant case, the assessee provided goods in deliverable state in India. The relevant finding of the Assessing Officer is reproduced as under :

> "19.4 Section 21 of the Sale of Goods Act provides that where there is contract for sale of specific goods and seller is bound to do something to the goods for the purpose of putting them in a deliverable state the property does not pass until such thing is done and the buyer has notice thereof. In the present case, the sale is not of standard goods but of components of passenger boarding bridges, unless these components are assembled, installed, commissioned and tested, these supplies would be worthless. These components and equipment reached the deliverable state only when their installation is completed and performance established through the provisional or final testing. The assessee has definite obligation to achieve this milestone and unless this is done the property cannot pass. Unlike other kinds of overseas supplies where the supplier has no other obligation beyond the point of shipment, in the present case, the obligation of the supplier extends to the geographical limits of India where he has to put the supply into a deliverable state. In the equipment being discussed in the present case, the various components are integral part of the wholesome technology and these cannot be viewed independently."

2.18 The Assessing Officer also referred to sections 41(1) and 41(2) of the Sale of Goods Act which provides that where goods are delivered to the buyer, which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunities of examining them for the purpose of ascertaining whether they are in conformity with the contract. The Assessing Officer finally observed in para 20 of the assessment order as title of the machinery supplied passed in India. The relevant para is reproduced as under :

> "20. A reading of the aforesaid sections of the Sale of Goods Act will show that where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. This clearly shows that operationalisation and full and guaranteed working condition in accordance with the technical specifications are the requirements for the contracted goods to be put into a deliverable state and the property does not pass until such thing is done, i. e., working condition as per the technical specifications and the buyer has notice

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thereof though the provisional acceptance test. As per the terms and conditions of the abovereferred agreements and the discussion in the para above it is amply clear that the assessee was responsible for procurement, transport, receiving., uploading and safe keeping of all the equipment required in the completion of work which include the supply of 620 TPD plant from Austria. In terms and conditions of the agreement, the offshore supplies become the property of the employer only when the same was delivered at the site even thereafter the contractor, i. e., the assessee continued to bear the risk in respect of such item as the same in its custody till installation, commissioning and testing."

2.19 The Assessing Officer, then proceeded to hold that the sale of equipment was concluded in India and the permanent establishment in India played a role in marketing and thus part of profit of supply of machinery of the TPD plant is directly attributable to the permanent establishment of the assessee in India. The relevant part of the finding of the Assessing Officer is reproduced as under :

"21. All these analysis makes it clear that the sale of equipment is concluded in India. Permanent establishment of the assessee in India was directly involved in design, build, manufacturing and supervision of commissioning of machinery for the TPD plant facility and supply of machinery for the TPD plant was needed to make this machinery for the TPD plant functional. These facts clearly suggest that there was extremely a close connection between the assessee and the permanent establishment in India, i. e., permanent establishment and the assessee-company were the same and one. It is a proven fact that supply of equipment were incidental and essential to design, build, manufacture, commission machinery for the TPD plant and is part of one and composite agreement. The assessee had earned supervision fee and income from supplies only from its business activities carried on through permanent establishment in India. All the transactions including supply of equipment offshore had taken place with the involvement of the permanent establishment of the assessee in India. The abovereferred to the factual matrix of this case that substantial part of the business activities of the assessee of manufacturing and commissioning of machinery for the TPD plant were carried out in the taxable territory of India and the supply of machinery for the TPD plant was incidental to works contract and for this reason a part of profit on supply is directly attributable to the permanent establishment of the assessee in India.

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21.1 It is not a case of a project where supervision services were required to fix up a plant and machinery, i. e., technical services were incidental to sale of plant and machinery. In the case of the assessee a contract was signed between the assessee and Century Pulp and Paper Company to design, built, manufacture and supervision of erection and commissioning of machinery for the TPD plant in India and supply of machinery for the TPD plant were incidental to works contract and were essential requirement and were part of these machinery for the TPD plant. In other words, supply of equipment was incidental to the main business activity of the assessee-company providing technical services for design, build, manufacture and supervision of installation, testing and commission of machinery for the TPD plant. For all these reasons, it is amply clear that there was sufficient territorial nexus between supplies and permanent establishment of the assessee-company in India. It is also important to consider the fact that the contract with Century Pulp and Paper Company was negotiated and signed in India.

21.2 In this case, supplies of equipment were made only to build and commission machinery for the TPD plant in India through permanent establishment of the assessee and these supplies were incidental to rendering technical services for manufacturing and supervision of erection and commissioning of machinery for the TPD plant. Accordingly, it cannot be pleaded that sale of machinery for the TPD plant was not directly connected with permanent establishment. It is also proved from the facts as recorded above that in this case that all the business activities of manufacturing and supervision of erection and commissioning of machinery for the TPD plant as well as incidental supplies were carried on in India (delivery at site) and a part profit on supply was attributable to the permanent establishment in India.

21.3 In view of the discussions contained above, it is held that the profit earned by the assessee from the supply of equipment is directly attributable to the permanent establishment of the assessee in India. The equipment machinery for the TPD plant needed for supervision for erection and commissioning of these facilities were manufactured by the assessee in Austria but were utilised for creation of machinery for the TPD plant in India. Therefore a part of by the assessee on offshore sale/supply was directly attributable to permanent establishment in India."

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2.20 The Assessing Officer computed the profit attributable to the permanent establishment in the light of the ratio of the decision of the hon'ble Delhi High Court in the case of *Rolls Royce Plc* v. *DIT (IT)* [2011] 339 ITR 147 (Delhi) at 35 per cent. of the profit from operation of supply of machinery. The relevant part of the order is reproduced as under :

"As discussed supra that out of the above activities drawing, designs and manufacturing of equipment is done outside India but marketing and related activities and supervision of erection and commissioning is done in India. As discussed supra, permanent establishment is played role in marketing and related activities and supervision.

Taking guidance from *Rolls Royce* 35 per cent. of the profit accruing from the offshore supplies to the Indian operations for the role played by the permanent establishment can be attributed. Profit from offshore supplies can be computed based on the assessee's global profitability after making certain adjustments for depreciation and provisions, etc. Another method can be to estimate a percentage of gross amounts received as offshore supply. For this, the profit margins of some comparable companies doing similar activity can be adopted as a guidance and profits attributable can be worked out.

The assessee has submitted global consolidated annual account which cannot be relied upon as it consolidates all the subsidiary companies accounts also. In the absence of standalone annual account a profit of 9.75 per cent. (profit margin estimated as per para 7 above) is assumed as profit earned by the company and 35 per cent. of such profits are attributed to permanent establishment.

With these remarks, the total income of the assessee is computed as under :

Income as per return of income filed on March 28, 2012 — Nil

Income from offshore supply

Calculation of income from offshore supply

Particulars	*FY 2009-10 (Rs.)*
Gross offshore supply revenues (INR) = exchange rate at 70.09	472,97,97,680
Profit on the basis of 9.75 per cent.	46,11,55,274
Attribution in India (%)	35%
Total taxable income	16,14,04,346

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2.21 The Assessing Officer passed the draft assessment order dated March 30, 2013 under section 143(3) read with section 144C(1) of the Act and attributed income from offshore supply to tax in India as computed above.

2.22 The objections filed by the assessee against the draft assessment order before the learned Dispute Resolution Panel, did not find any favour and rejected by the learned Dispute Resolution Panel in its direction dated December 27, 2013.

2.23 Pursuant to the direction of the learned Dispute Resolution Panel, the Assessing Officer passed impugned final assessment order dated January 2, 2014, confirming all the additions made in the draft assessment order. Aggrieved with the addition made in the final assessment order, the assessee is before the Tribunal raising the grounds as reproduced above.

Ground Nos. 1 and 2 of the appeal are general in nature and therefore 3
we are not required to adjudicate upon specifically.

3.1 In ground Nos. 3 (from 3(a) to 3(m)), the issue of income arising on supply of machinery held by the lower authorities as income accrued in the hands of the assessee as per the provisions of the Income-tax Act as well as under the provisions of the Double Taxation Avoidance Agreement between India and Austria, have been raised.

3.2 Before us, the learned counsel of the assessee filed a paper book containing pages 1 to 216 and made submissions in support of the grounds raised. The learned counsel also filed written submissions. The learned Departmental representative on the other hand supported the order of the lower authorities and contended that the assessee is liable for tax both under the Act as well as under the Double Taxation Avoidance Agreement between India and Austria in respect of composite works contract of supply as well as service. The learned Departmental representative also filed written submissions. The learned counsel filed his rejoinder to the submissions of the learned Departmental representative.

3.3 We have heard the rival submissions of both the parties and perused the relevant material on record including the order of the lower authorities and the paper book filed by the assessee.

3.4 In this case, the assessee has entered into two contracts with "Century Pulp and Paper Company", a division of M/s. Century Textile and Industries Ltd. :

(a) Equipment supply contract dated June 19, 2008—for engineering, designing, manufacturing, drawing and supplying of machinery for "620 TPD multilayer packaging coated board plant".

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(b) Service contract dated June 19, 2008—for supervision of erection, start up, training, commissioning and performance test of said machinery.

Both the above contracts have been signed in India on same date.

3.5 In the facts of the case, the contention of the assessee is that the supply of equipment is from outside India, which is only a offshore supply and no income corresponding to the same accrued or arisen in India in terms of the Act. The assessee has refuted the contention of the income-tax authorities that contract of supply and contract of the service both constitute a composite contract for setting up of the TPD plant. The assessee has also contested that there was no fixed placed permanent establishment as far as the supply contract is concerned and therefore no provisions of the Double Taxation Avoidance Agreement are applicable for income from supply of the contract is concerned.

3.6 The various issues have been raised in the above grounds. The first issue is whether the two contracts constitute a composite contract as held by the Assessing Officer or whether the machinery supply contract was only offshore supply, independent of contract of supervision of erection of the machinery.

Composite contract

4 Regarding the finding of the Assessing Officer that the contract is a composite contract for setting up a plant and the transaction has been segregated into two separate contracts for purchase and service for tax avoidance only and offshore supplies are integral part of supervision and final commissioning and installation of the TPD plant, the learned counsel of the assessee contended that the same are erroneous finding. The learned Assessing Officer has held that the supply of machinery was necessary and incidental to design, manufacture, installation, testing and commissioning of the TPD plant in India and the impugned contract is nothing but a consolidated contract for design, build, manufacture, supply, installation, testing and commissioning of machinery of the TPD plant, i. e., works contract and the contract cannot be subdivided as contract for sale of equipment and contract for technical services. The Assessing Officer placed his reliance on the decision in the case of *CIT* v. *Mitsui Engineering and Ship Building Co. Ltd.* [2003] 259 ITR 248 (Delhi) and *Hindustan Shipyard Ltd.* [2000] 119 STC 533 (SC) ; [2000] 6 SCC 579. The learned counsel of the assessee relied on the decision in the case of *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* [2007] 288 ITR 408 (SC) and submitted that obligation of the assessee for the contracts of supply of equipment and supervision are distinct and separate, which were executed by the assessee with

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separate prices and thus, it cannot be said that both contracts are a composite contract.

4.1 Regarding the finding of the Assessing Officer that situs of work is in India and objective of composite nature of the work is to provide the goods in deliverable state to Century Pulp and Paper Company, the learned counsel submitted that as far as situs of supply is concerned it was not in India but for installation it is within India.

4.2 The learned Departmental representative, on the other hand, submitted that the claim of the assessee that the supply and service contracts are separate, independent and severable contracts cannot be accepted on account of the following observations :

Provisions in the contracts—(pages are referred with reference to the assessee's paper book for 2010-11)

—Intention of the purchaser—"Whereas the purchaser *desires to Install a* 620 TPD multilayer packaging coated board plant. . . . .' (paper book for 2010-11), pages 157 and 186) and the assessee is committed to the success of the "*project*". (15, page 179)

—The term "*plant*" as used in the contract has a very wide ambit that includes in its sweep not only the "machinery" provided by supplier (3.1 ; page 162) but also the machinery otherwise procured by the purchaser (3.2 ; page 163) to be *erected* on site. (page 160)

—The term "*machinery*" also has a wide connotation that include "supports, embedment", etc. (3.1.2 ; page 162)

—Examination of the nature of goods supplied under supply contract, i. e., "press section" and "press rolls" (pages 14, 36) ; "wire section" and "coating section" (pages 19, 36, 45) ; "dryer cylinder" (pages 24 and 32) ; "head box" (page 28) ; "Mechanical drive" (pages 36 and 49) ; "MCS" (page 36) ; "DCS" (page 36) ; "MG dryer" (page 41) ; "parts for head box" (page 45) ; "parts for master reel" (page 45); "control cabinets" (page 45) ; "QCS with CD controls" (page 45) ; "air drying system" (page 49) ; "MG Hood" (page 54) ; "Hood and ventilation system" (page 58) ; "dewatering system" (page 58) ; "pneumatic system" (page 58) ; "control room equipment" (page 58) ; "fibre recovery system" (page 58) ; "dryer section" (page 62) ; "hydraulic system" (page 62) ; "lubrication system" (page 62) ; "wet end" (page 62) ; "approach flow system" (page 62) and "stock preparation" (page 62), etc., clearly bring out the fact that these *goods are not in a deliverable state as per the terms of the supply contract*. These are merely parts/sections of the "plant" and do not have any independent

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functions/usage for the purchaser and needs to be assembled to fulfil/satisfy the purpose of the contract.

—The above observation that the individual components supplied under the supply contract does not have any independent use for the purchaser is reconfirmed by clause 13.5 of the contract which states that "*The date of completion of delivery is the date of delivery of the last consignment*" to be supplied. (13.5, p. 171).

—Another important feature that establishes the inter-linkage between the supply and service contract is the provision for "*Monthly progress report*" (article 17 of the supply contract, page 180 and article 16 of the service contract, page 201). If the contention of the assessee is to be accepted, there is no need for a "monthly progress report" in respect of supplies that are independent of the service obligations.

—Perhaps, the most significant indicator of the inter-linkage and interdependency between the supply contract and service contract is the presence and primacy of the "*Performance warrantee* clause" (article 4 of the supply contract, page 163) which is one of the service/supervisory obligations of the assessee under the service contract. (article 2 of the service contract, page 191) This is the umbilical link between the supply and service contract. A separate article 4 in the supply contract is exclusively devoted to this which provides that "The supplier shall warrantee the performance of the plant and even the machinery/accessories to be provided by the purchaser have to fulfils the preconditions defined by the supplier." (page 163). Towards this end, the supply contract pre-supposes a number of "Test Runs" (article 4.2, page 163). Although "performance warrantee" and other tests are relevant and part of the service parameters, nevertheless, it finds prominent mention throughout the entire supply agreement. The primacy of this article/exercise can be gauged from the fact that the final acceptance of the goods supplied hinges upon the success of the performance warrantee test. Thus, as per article 6. "*The machinery will not be deemed to have been formally finally accepted by the purchaser until performance guarantees have been achieved . . . . After fulfilment of the performance guarantee, the purchaser will issue to the supplier a final acceptance certificate.*" (6.1, 6.2 and 6.3 ; page 166) Similarly, insufficient fulfilment of the performance guarantee parameters will liable the supplier for liquidated damages. (article 15.2, page 173) If this is not sufficient, as per article 7.3 of the general terms of contract "*If the supplier should commit a breach of non-fulfilment*

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of the minimum performance guarantees . . . . . then the purchaser shall have the right to terminate the contract" : (page 177)

—The service contract, on the other hand specifically provides in the scope of services provision for "personnel services for supervision of erection, start-up, training, commissioning and *performance test(s)*". (pages 186 and 191). Even though as per article 6.1(a) of the specific terms and conditions of contract provides that and the assessee argues that the purchaser shall carry out the erection, commissioning, startup and performance test(s) under the supervision of the supplier (page 193), article 7.1 provides that "*supplier shall be responsible for ensuring correctness of erection of all machineries supplied by the supplier*" (page 194) and in the case of "*non-fulfilment of the minimum performance guarantee, the purchaser shall have the right to terminate the service contract*". (article 6.2 of general terms and conditions to service contract, page 198)

—In other words, the "performance warrantee clause" under both the supply and service contract act as a cross-fall breach clause where the non-fulfilment of this clause may lead to the termination of both the supply as well as the service contract. The "machinery", "plant" and "project" shall not be complete unless and until the same clears "*performance warranty test*" and in the event of non-fulfilment of the minimum performance guarantee. (7.3, page 177) the supply contract can be terminated and the *price already paid* by the purchaser has to be refunded against *return of machinery already delivered*. (7.5, page 178). Similarly, the service contract can also be terminated for the non-fulfilment of the minimum performance guarantee. (6.2 ; page 198) *In fact, the terms and conditions governing the service contract are so identical to that of supply contract that clause 6.4 of the service contract also provides for the refund of prices paid by the purchaser and return of machinery received by it in the event of termination of service contract*. (6.4 ; page 198)

Accounting practice by the assessee

It is not that the provisions of both the supply and service contracts establish their compositeness and inter-linkage. In practice too, the assessee itself treats both the supply and service contracts as an indivisible composite contract. The assessee follows "*cash system of accounting*" for the recognition of its revenue. As per the terms of the service contract "remuneration"/"supervision charges" are payable on a fixed rate per man-day basis. (clause 3 ; page 191). The cost for services under the contract to be charged on the basis of actual services

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rendered using the daily rates. (3.9 ; page 193). As per clause 4 of the service agreement dealing with the terms of payment, "payments out of the letter of credit shall be made against the following documents : (a) supplier's monthly invoice (b) copy of monthly time sheet issued by the supplier and countersigned by the purchaser." (clause 4.2 ; page 193). However, *even though there is no provision of advance payment of "remuneration"/supervision fee payable under the service contract the assessee itself, accounts for the supervision fee received under the service contract as "advance received" "work-in-progress" (pages 95 to 97) under completion of contract method although it follows a "cash" system of accounting*. In the notes to the accounts for the assessment year 2012-13, the assessee states "3. The service contract dated June 19, 2008 was completed on March 19, 2012 and permanent establishment in India ceased to exist after the said date. The *completion certificate* has also been received from CPP. Accordingly, the income earlier treated as advance from customer have now been offered to tax and cost earlier treated as work-in-progress has been transferred to Pandl. 4(b) In relation to the agreement dated June 19, 2008, companies personnel visited the customer's site and as per the number of days visited and duration of the contract, permanent establishment came into existence in terms of the provisions of the Double Taxation Avoidance Agreement between India and Germany. Completed contract method has been followed by VPS in regard to this project. The contract was executed and *completion certificate was obtained* in the current financial year 2011-12 and all the payments were also received during the relevant year, thus, profit/loss of the said project has been recognised in the financial year 2011-12." (page 269, paper book 2011-12)

Another fact that lends credence to the fact that the contracts are intimately connected composite contracts is that *not only receipts from supervisory services are offered on "project completion" basis, various expenses related to the "project" are also claimed against these receipts*. Thus, during the assessment year 2010-11 expenses towards "technical planning execution outside India" and in 2011-12 expenses towards "technical planning cost", "sub-contractor's cost", "erection charges outside India", etc., were claimed against the supervision fee. In other words, while on the one hand the assessee claims that the contract for supply and the contract for services are two independent contracts not linked to each other, on the other, the assessee itself treats both these contracts are linked and recognises/offers the

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income from service contract after the "receipt of completion certificate". In the rejoinder, the learned counsel of the assessee submitted that the inference drawn by the learned Commissioner of Income-tax (Departmental representative) that because the appellant was bound by performance warranty clause and Century Pulp and Paper Company was entitle to termination the contract in the event of non-fulfilment of the same, the equipment supply and service contract were a composite contract and income from offshore works is ipso facto taxable in India, was incorrect inasmuch as the Revenue has failed to appreciate that the offshore works have been undertaken outside India in terms of section 9 of the Act. He submitted that once it is established that the title to the goods has been transferred to the buyer outside India, then, even in the case of composite contracts, income from offshore supply activity has to be segregated from the onshore activities undertaken in India and the taxability there of determined independently.

Findings

On considerations of the features of both the contracts highlighted by **5**
the learned Departmental representative, we are of the view that both the contracts cannot be seen independently. On a perusal of various clauses of the agreement, it is amply clear that the dominant purpose or intention of the buyer from the very beginning is installation of multilayer packaging coated board plant under the supervision of the assessee. As the assessee was also specialised in manufacturing of equipment required for setting up of the TDD plant, the assessee was involved in supply of the same. The plant in itself is not a set of machinery only but the contractor was required to construct a facility of manufacturing the products of the buyer. The various machineries supplied like "press section", "press rolls", "wire section", "coating section", "dryer section", etc., are kind of components of the plant to be constructed or erected under the supervision of the assessee. These goods in itself are components of plants, which has been delivered by the assessee. The intention of the parties was to provide to the buyer a plant in deliverable state which is also clear from the other terms of contract like date of completion of delivery as last date of delivery of last consignment, provision of monthly progress report both in supply and service contract, performance warrantee clause. The final acceptance of the supply of goods was dependent on the success of performance warrantee test. The service contract has a provision of termination clause in the case of failure of performance and return of machinery supplied under supply contract and refund of money. All these terms make it clear that both the supply and

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service contract are intrinsically linked and not severable. It was not possible for the buyer to assemble or erect the plant from any other contractor without the supervision of the assessee and therefore, the buyer made its intention of getting the goods in a deliverable state of plant. The artificial division of composite contract into supply and service may be on paper but the conduct of the parties and terms and condition of the contract manifest that in substance it was a composite contract. The accounting practice followed for recognising of revenue from service on completion of the project also support the intention of the parties to treat the erection of the plant as composite project.

5.1 All the above terms and conditions of the contract cited by the learned Departmental representative, when read together clearly bring out the real nature and essence of both the contracts as part of one composite and turnkey works contract.

5.2 The learned Assessing Officer has relied on the decision of the hon'ble Supreme Court in the case of *Hindustan Shipyard* (supra) as under :

> "10. In *Hindustan Shipyard* [2000] 119 STC 533 (SC) ; [2000] 6 SCC 579 , the question which arose for consideration was whether a contract constituted a sale or works contract. Laying down the tests therefore, having regard to the terms and conditions contained therein, it was opined that a contract of sale of goods was separate from a contained therein, it was opined that a contract of sale of goods was separate from a contract for works and labour. In regard to the categories of contract, it was stated (page 592 of [2003] 6 SCC and page 546 of [2000] 119 STC) :
>
> '(i) the contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price ;
>
> (ii) it may be a contract for work in which the use of the materials is accessory or incidental to the execution of the work ; and
>
> (iii) it may be a contract for supply of goods where some work is required to be done as incidental to the sale.'
>
> 10.1. Whereas the first contract was held to be a composite contract, the second was held to be a contract for work and labour not involving the sale of goods ; and the third was held to be a contract of sale where the goods were sold as chattels and the work done was merely incidental thereto."

5.3 The Assessing Officer has held that the supply of machinery was incidental to the erection and commission of the plant. The relevant paragraph is reproduced as under :

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"11. I have examined facts of this case along with the ratio decidendi above referred to judgment of the hon'ble Supreme Court and have noted that dictum of law for second category of contract (ii) as discussed above is squarely applicable to the identical facts of the case under consideration. In this case the assessee had entered into a contract with Century Pulp and Paper Company to design, build, manufacture, supply, installation, testing and commission of machinery for the TPD plant. The supply of machines was necessary and incidental to design, manufacture, installation, testing and commission of above facility, i. e., machinery for the TPD plant in India. It is not case of the assessee that the contract was signed for supply of machines only and some technical work was required to be done as incidental to machines only and some technical work was required to be done as incidental to sale of equipment. Even though the assessee during the assessment proceedings, mentioned that the supply of machinery for the TPD plant and the installation and commissioning services are separate and independent of each other, a careful perusal of this document reveal that as per the terms and conditions of the contract the effective mandate given to the assessee is in the nature of composite contract. The purpose and intention of Century Pulp and Paper Company was to install a fully functional machinery for the TPD plant in working condition at the airport and the assessee-company was given this responsibility. Therefore, respectfully following the above principle as laid down by the hon'ble apex court, I am of considered view that the impugned contract is nothing but a consolidated contract was for design, build, manufacture, supply, installation, testing and commissioning, of machinery for the TPD plant, i. e., works contract and the contract cannot be subdivided as contract for sale of equipment and contract for technical services as was wrongly been argued on behalf of the assessee."

5.4 Further, what constitute a contract as composite contract, the hon'ble Delhi High Court in the case of *CIT* v. *Mitsui Engineering and Ship Building Co. Ltd.* [2003] 259 ITR 248 (Delhi) has observed as under (page 249) :

"1. The question which has been raised in this appeal under section 260A of the Income-tax Act, 1961 (hereinafter referred to as the 'Act'), is the interpretation of 'royalty' as envisaged under *Explanation* 2 appended to section 9(1) of the Act. By reason of this *Explanation* which provides that the income specified therein shall be deemed to accrue or arise in India specifies six items which would

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come within the scope thereof The Commissioner of Income-tax (Appeals) as also the Income-tax Appellate Tribunal have arrived at a finding of fact that by reason of the agreement entered into by and between the assessee and the transferee, no royalty could become chargeable. Mr. Khanna, the learned counsel for the appellant, has in support of this appeal, however, submitted that design is one of the components which has been transferred together with engineering, manufacturing, shop testing, packing up to f. o. b. port of embarkation for a consideration of Rs. 4,74,000 and thus the same could come within the purview of one or the other clauses contained in *Explanation 2* to section 9(1). Having considered the submissions made at the Bar, we are of the opinion that it is not possible to apportion the consideration for design on the one part and engineering, manufacturing, shop testing, packing up to f. o. b. port of embarkation. In that view of the matter, in our opinion, the transfer of design, if any, vis-a-vis other would not come within the purview of the said *Explanation.* This aspect of the matter is covered by a Division Bench judgment of the Madras High Court in the case of *CIT* v. *Neyveli Lignite Corporation Ltd.* [2000] 243 ITR 459 (Mad) at page 463, where it was held as under :

'In a contract for the design, manufacture, supply, erection and commissioning of machinery which does not involve licence of the patent concerning the machinery, or copyright of its design, mere supply of drawings before the manufacture is commenced to ensure that the buyer's requirements are fully taken care of and the supply of diagram and other details to enable the buyer to operate the machines, and also to assure the buyer, that the machines will perform to the specification required by the buyer, such supply is only incidental to the performance of the total contract which includes design, manufacture and supply of the machinery.

The price paid by the assessed to the supplier is a total contract price which covers all the stages involved in the supply of machinery from the stage of design to the stage of commissioning. The design supplied is not to enable the assessee to commence the manufacture of the machinery itself with the aid of such design. The limited purpose of the design and drawings is only to secure the consent of the assessee for the manner in which the machine is to be designed and manufactured, as it was meant to meet the special design requirements of the buyer.

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The contract between the assessee and the manufacturer does not anywhere refer to any specific patent owned by the supplier which the buyer is permitted to exploit. All that the contract provides is an indemnity to the buyer, to protect the buyer against any action by a third party claiming patent, trade mark or other rights in the equipment supplied.

None of the sub-clauses in *Explanation 2* under section 9(1)(vi) would, in the circumstances of this case, be capable of being regarded as covering the design and engineering carried out by the supplier of the machinery abroad. There is no transfer or licence of any patent, invention, model or design. The design referred to in the contract is only the design of the equipment required to be manufactured by the supplier abroad and supplied to the purchaser. The information concerning the working of the machine is only incidental to the supply as the machinery was tailor-made for the buyers. Unless the buyer knows the way in which the machinery has been put together, the machinery cannot be maintained in the best possible way and repaired when occasion arises. No licence of any patent is involved. Sub-clause (vi) and also (vii) of section 9(1) would have no application as the design was only preliminary to the manufacture and integrally connected therewith. The other three sub-clauses also in the circumstances of the case are not attracted.'

2. In view of the aforementioned position, we are of the opinion that no substantial question of law arises for consideration in this appeal.

3. The appeal stands dismissed."

5.5 The hon'ble Andhra Pradesh High Court in the case of *L and T Ltd.* (supra) quoted the observations of the hon'ble Supreme Court in the case of *State of Karnataka* v. *Bangalore Soft Drinks P. Ltd.* [2000] 117 STC 413 (SC), where the hon'ble Supreme Court held that "In turnkey projects, more particularly of the kind involved in this batch of writ petitions, the same person has been entrusted with the responsibility of procuring material, and of erection and installation of equipment. While in-built safeguards are provided in all the contracts to ensure quality of the material, and effective performance of the erection contract, the supply contracts, in substance, do not absolve the petitioners-contractors of their obligations of erection and installation of equipment after the goods are sold by them to the owner. The petitioners-contractors' obligations, under both the supply and erection contracts, cease only after the turnkey project becomes

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operational, and after final payment is made both for supply of material and for erection and installation of equipment".

5.6 Similarly, the hon'ble Andhra Pradesh High Court again quoted the hon'ble Supreme Court in the case of *Indure Ltd.* v. *CTO* [2010] 34 VST 509 (SC) ; [2010-TIOL-79-SC-CT] and observed that : "32. . . . . The goods supplied to the owner, under the supply contracts, are tailor made goods, and cannot be bought off the shelf. Such goods cannot, ordinarily, be sold to another except for its use in turnkey projects of a similar nature. The petitioners have been entrusted with the work mainly for their expertise in erection and installation of plants in the execution of turnkey projects. As they were entrusted with the work of erection and installation, the petitioners contractors have also been entrusted with the task of procuring material therefor. The functions relating to the supply of material, and rendering services of erection and installation, are integrally connected and are interdependent . . . . . while the form of the contracts indicate that they are two separate contracts, in substance they are one single indivisible works contract for supply of material and for erection and installation of equipment".

5.7 In the instant case also, the machinery components have been imported in India to commission a custom-made plant for the buyer and those imported goods may not be used for any other customer. The assessee has been entrusted the work of commissioning of the TPD plant in view of the expertise in this field. Thus, the ratio of the above decision squarely applied over the facts of the instant case.

5.8 The ratio of the decision in the case of *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* (supra) is not applicable over the facts of the instant case as supply obligation and service obligation are interlinked and complement to each other. In the case of *Ishikawajima-Harima Heavy Industries Ltd.* (supra), the party who supplied the goods and erected the plant were different entities but in the instant case the party who supplied the goods and supervised the erection are one and the same party. Further, it was not possible for the buyer to erect the plant without the supervision of the assessee. In the case the first shipment of goods was dispatched from the Austria from September 14, 2009 and the last shipment in the year under consideration was shipped on December 9, 2009. The shipment of the goods have been supplied in the subsequent year also. The personnels of the assessee-company arrived in India on December 14, 2009 and remained till commissioning of plant. As machineries have been dispatched by sea, its arrival in India takes a period of 20 days to 30 days.

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Thus, the arrival of the goods and the arrival of the personnels of the assessee coincide and run concurrently.

5.9 The Tribunal in the case of *Shanghai Electric Group Co. Ltd.* v. *Dy. CIT* in I. T. A. Nos. 224 to 227/Delhi/2015, dated July 14, 2017 ; [2018] 10 ITR (Trib)-OL 339 (Delhi) has held that for two contracts to be composite one, dominant nature of an agreement should be seen. The Tribunal referred to the decision of the hon'ble Supreme Court in the case of *Bharat Sanchar Nigam Ltd.* v. *Union of India* [2006] 3 VST 95 (SC) ; [2006] 145 STC 91 (SC) ; [2006] 282 ITR 273 (SC) ; [2006] 6 RC 276 ; [2006] 3 STT 245. The relevant paragraph of the order of the Tribunal is reproduced as under (page 433 of 10 ITR (Trib)-OL) :

> "The hon'ble Supreme Court's observation in the case of *Bharat Sanchar Nigam Ltd.* v. *Union of India* [2006] 282 ITR 273 (SC) are relevant to understand the 'dominant nature of an agreement'. The relevant portions of the same has been extracted herewith (page 297 of 282 ITR) :
>
> 'The reason why these services do not involve a sale for the purposes of entry 54 of List II is, as we see it, for reasons ultimately attributable to the principles enunciated in *State of Madras* v. *Gannon Dunkerley and Co. (Madras) Ltd.* [1958] 9 STC 353 (SC), namely, if there is an instrument of contract which may be composite in form in any case other than the exceptions in *article 366(29A)*, unless the transaction in truth represents two distinct and separate contracts and is discernible as such, the State would not have the power to separate the agreement to sell from the agreement to render service, and impose tax on the sale. The test therefore for composite contracts other than those mentioned in *article 366(29A)* continues to be—Did the parties have in mind or intend separate rights arising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is to as what is 'the substance of the contract'. We will, for the want of a better phrase, call this the dominant nature test." (emphasis[1] supplied)

5.10 The Tribunal also considered the decision of the Authority for Advance Rulings in the case of *Roxar Maximum Reservoir Performance WLL, In re* [2012] 349 ITR 189 (AAR) as under :

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"217. We draw our support from the decision of the Authority for Advance Rulings in the case of *Roxar Maximum Reservoir Performance, Shanghai Electric Group Co. Ltd. v. Dy. CIT* (I. T. A. Nos. 224 to 227/Delhi/2015, 3552/Delhi/2015 and 58 and 59/Delhi/2017 dated July 14, 2017), had relied upon the judgment in *Ishikawajima-Harima*, and held that :

'A contract has to be read as a whole. The purpose for which the contract is entered into by the parties is to be ascertained from the terms of the contract. In the case on hand, ONGC clearly called for a contract for "services for supply, installation and commissioning of 36 manometer gauges". The purpose of the contract is the installation of the gauges at site to enable ONGC to carry out its operations. I have quoted earlier the relevant portion of the contract. On a reading of the same, there cannot be any doubt that that the contract in question was for erection and commissioning of 36 manometer gauges for the use of ONGC. The contract is clearly not one for sale of equipment. Nor is it one for mere erection of the equipment. It is a composite contract for supply and erection at sites within the territory of India. What is paid for by ONGC is for the supply and erection done in India. The payment is received by the applicant for the performance of the contract as a whole in India. It is, therefore, clear that the income to the applicant accrued in India.'"

5.11 In view of the above, we hold that the supply and service contracts represent a single, composite turnkey works contract.

Income deemed to accrue or arise in India as per section 9(1)(i) of the Act

6 The next issue in the case is whether the income from supply agreement is taxable in India. As per section 9(1) of the Act income accruing or arising from any business connection in India is deemed to accruing or arising in India. The relevant part of the section is reproduced as under :

"9.(1) The following incomes shall be deemed to accrue or arise in India :—

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India."

6.1 The assessee has objected the business connection on the ground that sale of the property has been made from outside India and thus offshore supply is not taxable in India as per section 9(1)(i) of the Act.

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6.2 Now, we take up the contention of the assessee that supply of machinery was only offshore supply and not liable for tax in India in terms of section 9(1)(i) of the Act in view of no business connection in India.

6.3 The learned counsel of the assessee in relation to the issue submitted three factual aspects of the contract. Firstly, he submitted that the title of goods in dispute was transferred by the assessee to the purchaser outside India. He referred to article 7.1 of the appendix A (specific terms and conditions of the contract) to the offshore supply contract, available on page 166 of the paper book. According to the learned counsel, the said appendix specifies that the ownership and risk of equipment supplied under the laws of supply contract would be transferred in favour of the buyer outside India at the port of shipment after the machinery is put on board of the ship on CIF Incoterms 2000 basis. For ready reference, clause 7.1 of the offshore supply contract, referred by him is reproduced below :

> "7. Transfer of ownership and risk
>
> 7.1 Notwithstanding anything contained elsewhere in the contract it is agreed that the property and risk of the machinery *will stand transferred to the* PURCHASER *from the* SUPPLIER *outside India at the port of shipment after the machinery is put on board of the ship on CIF Incoterms 2000 basis*." (emphasis[1] supplied)

6.4 Secondly, he referred to article 12 of appendix A (specific terms and conditions of the contract) to the offshore supply contract, available on pages 170-171 of the paper book and submitted that it specifies that the assessee shall arrange the transit insurance on its own cost and that the shipping documents are to be prepared in the name of Century Pulp and Paper Company. The relevant extract of the above terms of the offshore supply contract is reproduced below :

> "12. *Shipment and insurance*
>
> 12.2 The documents should be prepared in the name of Century Pulp and Paper (Prop. : Century Textiles and Industries Ltd.)
>
> 12.4 The SUPPLIER shall arrange the transit insurance at his cost from the SUPPLIERS' warehouse to the PURCHASERS' warehouse at site at Lalkua, (Distt. Nainital), Uttarakhand, India."

6.5 Thirdly, he referred to articles 8 (eight) and 9 (nine) of appendix A (specific terms and conditions of the contract) to the offshore supply contract, available on pages 166-168 of the paper book and submitted that it specifies contract price amounting to EURO 68,498,800, which was payable

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in foreign currency. The relevant extract of article 8 of the offshore supply contract reproduced as under :

"8. *Price*

8.1 Price for the supply as per scope of supply as per article 3 shall be Euro 68,498,800 composed as follows :

(a)	Machinery and equipment		Euro	6,17,22,800
(b)	Spares		Euro	67,76,000
		Total	Euro	6,84,98,800

9. *Terms and mode of payment . . . . .*

9.6 The payment stated under article 9.1.2 shall be made through an irrevocable letter of credit to be opened by the PURCHASER in favour of the SUPPLIER within 30 (thirty) days after signing of the CONTRACT, which shall be valid until 1 (one) month beyond the contractual FOB delivery time. The letter of credit shall allow for partial shipments. In general, transshipment will not be allowed but based on specific request, discrepancy in letter of credit may be accepted by us. The letter of credit shall be payable in the country of the SUPPLIER and confirmed by a international bank and the confirmation charges will be borne by the PURCHASER."

6.6 With regard to the contention that sale of equipment effected outside India and thus no income accrues or arise in India on supply of goods, the learned counsel relied on the decision of the hon'ble Supreme Court in the case of *Seth Pushalal Mansinghka (P.) Ltd.* v. *CWT* [1967] 66 ITR 159 (SC) and the decision of the hon'ble Supreme Court in the case of *Mahabir Commercial Co. Ltd.* v. *CIT* [1972] 86 ITR 417 (SC). The learned counsel emphasised that sale of goods had taken place outside India due to the reasons that :

(i) The intention of the parties that transfer of title shall take place outside India is clear from the article 7.1 of the appendix to the offshore supply contract, which has clearly mentioned that ownership of the equipment shall be transferred to CPP at the port of shipment.

(ii) Bill of lading (BOL) names CPP as the notifying party of goods.

(iii) the commercial invoice has been drawn by the Voith (the assessee) on CPP (buyer).

6.7 The learned counsel of the assessee referred to the Sale of Goods Act, 1930 (in short, "the SGA") and submitted that property in goods was transferred the moment the assessee dispatched the goods for transmission to the Century Pulp and Paper Company. He submitted that it was always

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the intention of the parties that the property in equipment shall be vested in the Century Pulp and Paper Company at the port of shipment. The learned counsel referred to the decision of the hon'ble Delhi High Court in the case of *DIT* v. *Ericsson A. B.* [2012] 343 ITR 470 (Delhi) wherein it is held that if the equipment was manufactured outside India and even the sale took place outside India, then the fact that equipment was subject to acceptance test in India, did not alter the legal position that title of the equipment passed outside India. The learned counsel also relied on the decision of the hon'ble Supreme Court in the case of *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* [2007] 288 ITR 408 (SC) to support his contention that sale in the case of the assessee has been concluded outside India. The assessee drawn comparison with the above case as under :

Particulars	*Ishikawajima's case*	*Appellant's case*
Title transferred in favour of buyer outside India at the port of shipment of equipment and materials	Yes	Yes
Consideration for offshore supplies receivables in foreign currency	Yes	Yes
Buyer named as insured/co-insured	Yes	Yes

6.8 The learned counsel submitted that the ratio of the above decision applies over the fact of the instant case because in view of the provisions of the Sale of Goods Act, 1930 (SG Act), the property in equipment supplied by Voith (i. e., the assessee) to Century Pulp and Paper Company was transferred in favour of Century Pulp and Paper Company, when the equipment was unconditionally appropriated to the contract or in other words when the equipment was dispatched for transmission to Century Pulp and Paper Company. The learned counsel submitted that in view of the facts of the case, the equipment was sold by the Voith outside India and the entire activities essential for transfer of the title of the equipment took place outside India and therefore property in equipment shall be vested in Century Pulp and Paper Company at the port of shipment. He further submitted that bill of lading (BOL) constituted a document of title of the equipment and the same was drawn to shown Century Pulp and Paper Company as the consignee which further substantiated property in equipment had been intended to be transferred to CPP at the point of dispatch of equipment. He also referred to section 1 of the Indian Bills of Lading Act, 1856, according to which the consignee of goods named in the bill of lading to have vested all rights of suit and subject to the same liabilities in respect of such goods, if the contract contained in the bill of lading has been made with himself.

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6.9 Further, the learned counsel elaborated that no income deemed to accrue or arise in India because no income accrued or arisen to the assessee whether directly or indirectly, through or from any business connection in India as it specified in section 9 of the Act due to following reasons :

—the sales were independently made by the assessee to CPP on principal-to-principal basis.

—the sales are concluded outside India.

—in connection with the contract in question, no business operations were carried out by the assessee in India.

6.10 The learned counsel accordingly submitted that in view of no business connection in India, no part of income can be said to be deemed to accrue or arise in India. In support of his contention he relied on the decisions of the

(i) The hon'ble Delhi High Court in the case of *DIT* v. *Ericsson A.B.* [2012] 343 ITR 470 (Delhi). Wherein it is held that the fact that supply contract was signed in India or the equipment were subject to acceptance test by the Indian customer was not relevant and income from supply of equipment was held to be not taxable in India if no business connection existed within the meaning of section 9(1)(i) of the Act.

(ii) The Tribunal Delhi Bench in the case of *Nokia Networks OY* v. *Jt. CIT* [2018] 65 ITR (Trib) 23 (Delhi) (I. T. A. Nos. 1963 and 1964/ Delhi/2001) wherein, inter alia, it was held that mere provision of marketing activities does not lead to creation of a business connection.

6.11 The learned counsel submitted that the issue in dispute of off-shore supply of goods not liable to tax in India, is covered in favour of the assessee in view of the ratio of the following decisions :

(i) *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* [2007] 288 ITR 408 (SC).

(ii) *CIT* v. *Hyundai Heavy Industries Co. Ltd.* [2007] 291 ITR 482 (SC).

(iii) *DIT* v. *LG Cable Ltd.* [2011] 237 CTR 438 (Delhi).

(iv) *Hyosung Corporation, In re* [2009] 314 ITR 343 (AAR) (AAR No. 773 of 2008) further affirmed by the hon'ble Delhi High Court (W. P. (C) No. 2765 of 2010 and C. M. No. 5515 of 2010).

6.12 On the other hand, the learned Departmental representative submitted that an identical issue involving the transfer of title to the property and risk was before the Income-tax Appellate Tribunal in the case of

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Baker Hughes Asia Pacific Ltd. v. *Addl. DIT (IT)* [2014] 34 ITR (Trib) 192 (Delhi) ; [2014-TII-104-ITAT-DEL-INTL] where the Income-tax Appellate Tribunal had an occasion to consider a gamut of decisions including the decisions of the hon'ble Supreme Court in the case of *Ishikawajima-Harima Heavy Industries Ltd., DIT* v. *LG Cables Ltd.* [2011-TII-02-HC-DEL-INTL], *CIT* v. *Hyundai Heavy Industries Co. Ltd.* [2007] 291 ITR 482 (SC) ; [2007-TII-02-SC-INTL], *DIT* v. *Nokia Networks OY* [2013] 358 ITR 259 (Delhi) ; [2012-TII-49-HC-DEL-INTL] and *Skoda Export* v. *Addl. CIT* [2003-TII-34-HC-AP-INTL]. The Income-tax Appellate Tribunal after considering the above decisions of the hon'ble Supreme Court and that of the hon'ble Delhi and Andhra Pradesh High Courts as well as that by the Special Bench approved by the hon'ble Delhi High Court in the case of *Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269 (Delhi) [SB] ; [2005-TII-10-ITAT-DEL-SB-INTL] held as under:

> "155. In our opinion, this argument cannot be accepted because CIF as understood in INCO terms, no where contemplates passing of title simultaneously with passing of risk. CIF Chennai Airport implies that up to the Chennai Airport, the supply is to be arranged by seller. seller has to pay cost, insurance, freight and risk during the carriage of goods. However, loss or damage to the goods and risk is to be borne by the purchaser. This does not imply that ownership has also passed to purchaser. It is not correct to say that risk and title pass simultaneously. There can be agreement for passing of risk before passing of title per se. As per section 19 of the Sale of Goods Act, it is primarily the intention of the parties when the title to the goods is to pass. The true test is when the buyer gets the right to dispose of the goods, i. e., when the buyer acquires the control over the goods . . . . Therefore, the intention is to be gathered from the deed itself."

6.13 He submitted that in the light of the above, the Income-tax Appellate Tribunal after examining the terms of the contract concluded that—

> "161. Thus, all the terms are summarised as under :
>
> (i) The agreement was signed in India.
>
> (ii) The delivery of documents was to be in India.
>
> (iii) Supply was at CIF Chennai Port.
>
> (iv) The payment was to be made within 30 days of receipt of goods in India.
>
> (v) The risk though passed at the port of shipment but that was also subject to packing of goods as per the terms of agreement.

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(vi) The passing of title was as per the terms of deed.

(vii) The deed does not specify that the title passed outside India and therefore, the intention is to be gathered from the entire terms of agreement as discussed above.

162. It is true that all these aspects when considered independently, may or may not lead to the conclusion that the title passed in India but cumulative consideration of all the terms leads to inescapable conclusion that the only intention of the party was to appropriate the goods in India."

6.14 The learned Departmental representative further submitted that the contention of the Revenue is also supported by the hon'ble Andhra Pradesh High Court's decision in the case of *Larsen and Toubro Ltd.* [2015-TIOL-3055-HC-AP-CT] ; [2016] 88 VST 422 (T&AP) which has followed the decision of the hon'ble Supreme Court in the case of *Usha Beltron Ltd.* v. *State of Punjab* [2005] 7 SCC 58.

7 We have considered the rival submissions of the parties on the issue in dispute. We find that the hon'ble Supreme Court in the case of *Ishikawajima-Harima Heavy Industries Ltd.* v. *DIT* (supra) has held that signing of contract in India was of no material consequences while determining taxability of offshore supply of equipment since all the activity in connection with such supply were undertaken outside India and could not, therefore, be deemed to accrue or arise in India. The hon'ble Delhi High court in the case of *DIT* v. *Ericsson A. B.* (supra) has held that the place of negotiation, the place of signing of agreement or formal acceptance thereof or other responsibility of the assessee were irrelevant consideration for determining taxability of offshore supply of equipment. The relevant extract of the decision is reproduced as under (page 495 of 343 ITR) :

"The aforesaid analysis will bring forth the legal position that the place of negotiation, the place of signing of agreement, or formal acceptance thereof or overall responsibility of the assessee are irrelevant circumstances. Since the transaction relates to the sale of goods, the relevant factor and determinative factor would be as to where the property in the goods passes. In the present case, the finding is that property passed on the high seas. Concededly, in the present case, the goods were manufactured outside India and even the sale has taken place outside India. Once that fact is established, even in those cases where it is one composite contract (though it is not found to be so in the present case) supply has to be segregated from the installation and the only then would question of apportionment arise having regard to

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the expressed language of section 9(1)(i) of the Act, which makes the income taxable in India to the extent it arises in India."

7.1 In the instant case also, the contract agreements have been signed in India, which in view of the above decisions are not relevant consideration for determining the taxability of offshore supply by the assessee.

7.2 In the case of *Ishikawajima-Harima Heavy Industries Ltd.* (supra), wherein the contractor retained care, custody and control of the equipment and had to exercise due care thereof until (a) provisional acceptance of the work (b) termination of the contract, although the title to the equipment was to passed outside India. The hon'ble court held that since all the activity in connection with the offshore supply were performed outside India, income from also supply was not liable to tax in India. In the case of the *DIT* v. *Ericsson A. B.* (supra) the hon'ble court after analysing the clauses of the agreements held that conditions such as formal acceptance of the equipment or overall responsibility of the assessee for completion of the project are irrelevant for determining the taxability of offshore supply of the equipment. The hon'ble court held that for no taxability of offshore supply in India, the property and risk in the equipment must be passed outside India. The hon'ble Andhra Pradesh High Court in the case of *Addl. CIT* v. *Skoda Exports, Praha* [1988] 172 ITR 358 (AP) held that for determining taxability in offshore supply one has to apply the test of predominance and decide where the sale took place. In the case of *Hyosung Corporation, In re* [2009] 314 ITR 343 (AAR), the Authority for Advance Rulings held that the responsibility of the supplier for quality and performance of the equipment should not be construed as a condition which postpone the transfer of the title in goods till that time. The hon'ble Delhi High Court in the case of *DIT* v. *LG Cable Ltd.* [2011] 237 CTR 438 (Delhi) held that buyer's right to examine and repudiate the goods in law does not indicate the property in goods has not passed.

7.3 The contention of the assessee is that sale of goods has taken place outside India in view of the intention of parties as reflected in various clauses of agreement particularly article 7.1 of Appendix A, bill of lading in the name of the purchaser and commercial invoice in the name of the purchaser. In all the decisions, common thread is that title in property and risk to buyer is passed at a time when parties to contract intend it to transfer.

7.4 According to section 19(1) of the Sale of Goods Act, 1930 (SG Act) the property is transferred to the buyer at such time as the parties to the contract intended to be transferred. Further section 19(2) specifies that for the purpose of ascertaining the intention of the parties, regard shall be given to the terms of contract, conduct of the parties and circumstances of

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the case. Further, section 19(3) of the Sale of Goods Act specifies that unless a different intention appears, rules contained in sections 20 to 24 rules for ascertaining the intention of the parties as to the time at which the property and goods is to passed to the buyer. The relevant section of the Sale of Goods Act, 1930 are reproduced for ready reference :

> "2. *Definitions*.—'(4) 'document of title to goods' includes bill of lading, dock warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt (multimodal transport document), warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented . . .
>
> (6) 'future goods' means goods to be manufactured or produced or acquired by the seller after making of the contract of sale.
>
> 18. *Goods must be ascertained*.—Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.
>
> 19. *Property passes when intended to pass*.—(1) Where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to contract intend it to be transferred.
>
> (2) For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.
>
> (3) Unless a different intention appears, the rules contained in sections 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in goods is to pass to the buyer.
>
> 23. *Sale of unascertained goods and appropriation*.—(1) Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.
>
> (2) Delivery to carrier—Where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.

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26. *Risk prima facie passes with property.*—Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not . . ."

7.5 We find that though in the instant case, article 7.1 (supra) specifies that the ownership and risk of the equipment supplied under the off-shore supply contract would be transferred in favour of the buyer outside India at the port of shipment. But when we examine the intention of the parties from various clauses of the agreements, we find that in both the agreements, the intention of the buyer was to install the TPD plant in connection with expansion project, and which is clear from opening paragraphs of the agreement on first page of both the agreements, available on pages 157 and 186 of the paper book, which reads as under :

"*Supply contract*

WHEREAS the PURCHASER desires to install a 620 TPD MULTILAYER PACKAGING COATED BOARD PLANT in connection with PURCHASER'S expansion project.

And

WHEREAS the SUPPLIER is capable and desirous of designing, engineering, manufacturing and supplying imported MACHINERY for the 620 TPD MULTILAYER PACKAGING COATED BOARD PLANT as set-forth in this CONTRACT.

Service contract

WHEREAS the purchaser desires to install 620 TPD MULTILAYER PACKAGING COATED BOARD PLANT in connection with purchaser's expansion project.

And

WHEREAS the SUPPLIER is desirous of providing services for supervision of erection, start-up, training, commissioning and performance test(s) of the 620 TPD MULTILAYER PACKAGING COATED BOARD PLANT."

7.6 The clause 3.2 of the agreement, which is available on page 163 of the paper book, also refers that as far as purchaser's scope of supply was concerned, it was "the PLANT".

7.7 Under the supply agreement, the supplier has warranted the performance of the plant. The terms of guaranteed performance, available on page 163 of the paper book, reads as under :

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"4.2 *Demonstration of guaranteed performance*

4.2.1 For the purpose of demonstration of warranted performance, the plant shall be subject to test run(s), which shall be arranged and carried out within 6 (six) months after commissioning of the plant.

4.2.2 The performance warrantees shall be deemed to have been fulfilled if in the test run(s) the warranted performance parameters as per annexure IH have been achieved.

4.2.3 If the first test run(s) as per article 4.2.1 are unsuccessful within a period of six months after commissioning for reasons for which the SUPPLIER is responsible, the test run(s) shall be repeated within another period of 3 (three) months after SUPPLIER'S necessary rectifications, replacements and/or additions to be carried out in a reasonable time. The repetition of such tests run(s) shall be carried out with the same procedure as mentioned in this article. Expenses for SUPPLIER'S personnel for the second test run(s) shall be borne by SUPPLIER.

4.2.4 If the second test run(s) during the second period of 3 (three) months are also unsuccessful due to SUPPLIER'S fault, both parties will mutually decide which further steps shall be made in order to solve the problems related to the performance warrantee(s).

4.2.5 In case there is some disruption in the course of the first warrantee test run(s) in provision of items under article 4.2.6 hereinafter by PURCHASER for reason beyond their control, PURCHASER shall be given a maximum of (6) six weeks time from the date of receipt of the above mentioned notice for warrantee tests to fully comply with the requirement of article 4.2.6 hereinafter, in this case, the second or third guarantee test run(s) will be held on a mutually agreeable date, the expenses for the SUPPLIER'S personnel shall be borne by the PURCHASER.

4.2.6 The above performance warrantees are subject to the conditions and pre-requisites mentioned in annexure III.

4.2.7 If these test run(s) cannot be successfully completed latest by 18 (eighteen) months after last major delivery for reasons for which the SUPPLIER is not responsible, the performance warrantees shall be deemed to have been fulfilled at such date.

7.8 The warranty was provided by the suppler with reference to the date of commissioning. The relevant clause available on page 164 of the paper book reads as under :

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"5.2 The warranty period of MACHINERY supplied by SUPPLIER shall be 12 (twelve) months from the date of commissioning but not more than 21 (twenty-one) months from the date of delivery at port of shipment of last consignment of MACHINERY excepting minor items or spares, which do not effect the erection and commission schedule of the plant. During the warranty period if any part of the MACHINERY requires repair and/or replacement, the warranty period for the newly repaired part and/or the replacement shall also be 12 (twelve) months from the date on which they are put into operation, but not more than 21 (twenty-one) months after the date of delivery at site of each part, in the case the operation of the MACHINERY is stopped for a period of, or over 14 (fourteen) days caused by the repair or replacement due to SUPPLIER'S responsibility, then the warranty period for the MACHINERY shall be prolonged according to the stoppage correspondingly.

5.3 During the warranty period, if any defect of MACHINERY is found due to SUPPLIER'S responsibility (except for normal wear and tear) the PURCHASER shall inform the SUPPLIER in detail specifying the nature of the defect by fax/e-mail immediately. The PURCHASER'S notice shall still be valid within 30 (thirty) days after the expiration of the warranty period if the defect occurred within the warranty period. SUPPLIER shall within 15 (fifteen) days of receiving the PURCHASER'S notice inform the PURCHASER whether it will be sending its personnel over to the plant side or request the PURCHASER to entrust the appropriate Indian authority to investigate the cause of the defect. Should the defect be attributable to SUPPLIER'S responsibility, the SUPPLIER shall depute its personnel to remove the defect or replace the faulty parts at its option. The PURCHASER shall render its assistance to the extent possible free of charge during the course of the repairs or replacement. In the case of slight defect, the PURCHASER with SUPPLIER'S authorisation and instruction may adjust the same. The relevant material cost shall be to the SUPPLIER'S account and the relevant labour cost in India shall be to the PURCHASER's account materials required to meet the performance guarantees and contractual obligations during warranty period—If attributable to the SUPPLIER, shall be arranged by the SUPPLIER free of cost, all freight and duty paid."

7.9 The final acceptance of the machinery was subjected to the final acceptance test only. The relevant clause of the agreement available on page 166 reads as under :

"*Final acceptance*

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6.1 During the performance guarantee test as stipulated in this CONTRACT, the 620 TPD MULTILAYER PACKAGING COATED BOARD PLANT will be operated by and under the supervision of PURCHASER according to the operating instructions issued by SUPPLIER. The MACHINERY will not be deemed to have been formally finally accepted by the PURCHASER until performance guarantees are achieved, the liquidated damages have been paid or waived, or the performance guarantees have been deemed fulfilled as set out below.

6.2 After fulfilment of the performance guarantees as per annexure III or if the performance guarantees are deemed to be fulfilled as stipulated in article 4.2.7 the purchaser win issue to the supplier a final acceptance certificate.

6.3 In case the MULTILAYER PACKAGING COATED BOARD PLANT has not achieved the required performance parameters but come to level of minimum acceptable level as per annexure III and the relevant liquidated damages have been paid by the SUPPLIER or if the PURCHASER has decided to waive off such liquidated damages, then the MULTILAYER PACKAGING COATED BOARD PLANT will be deemed to be finally accepted by the PURCHASER."

7.10 Annexure B of the supply agreement contains termination clause. In the event of termination, supplier was bound to return the price already paid against the machinery. The relevant clause is reproduced as under :

"7.5 In the event of termination according to article 7.2 for reasons attributable to the SUPPLIER the exclusive consequence for both parties shall be the SUPPLIER'S waiver for payment of the unexecuted part of the CONTRACT and the PURCHASER'S waiver for delivery of the unexecuted part of the CONTRACT. In the event of termination according to article 7.3 for reasons attributable to the SUPPLIER the exclusive consequence for both PARTIES shall be the re-exchange of the executed parts of the CONTRACT, i. e., repayment of the price already paid by the PURCHASER against returning of MACHINERY already delivered."

7.11 The said repayment for return of machinery was also provided in the service contract, which read as under :

"6.4 in the event of termination according to article 6.2 for reasons attributable to the SUPPLIER the exclusive consequence for both PARTIES shall be the re-exchange of the executed parts of the CONTRACT, i. e., repayment of the price already paid by the PURCHASER against returning of MACHINERY already delivered."

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7.12 If due to termination of service contract, if the contract of supplying of machinery also gets effected that shows that both the contracts are interconnected and composite.

7.13 The learned counsel of the assessee has relied on the decision of the hon'ble Supreme Court in the case of *Mahabir Commercial Co. Ltd.* (supra), wherein it is held as under :

> "As per the provisions of section 5 of the Act, the total income of a non-resident includes income which is received or deemed to be received in India or which accrues or arises, or is deemed to accrue or arise to the non-resident in India. Arguably, a sale undertaken by a non-resident to a resident outside India should not be subject to tax in India. However, the Act does not define what constitutes sale made outside India or in India. Therefore, guidance could be sought from judicial pronouncements. The Supreme Court has held that whether a sale has been made in India or outside India would depend upon the facts of the case. For instance, the apex court has held that in case the bill of lading accompanying the goods is in the name of the Indian buyer, then the transaction is complete in the sellers' count, and the delivery of goods, and the sale, is deemed to have taken place outside India. However, if the seller retains control over the goods by taking the bill of lading in his own name, the delivery and sale could be said to have taken place in India. . . .
>
> sale of goods on a CIF basis does not necessarily imply that sale as concluded in India."

7.13 Thus, we find that the hon'ble Supreme Court has held that sale has been made in India or outside India would depend upon the facts of the case, though instance of bill of lading has been given as one of the criteria of deciding the sale inside or outside India.

7.14 In the instant case, the learned counsel claimed that the equipment to be supplied by the assessee to Century Pulp and Paper Company falls under the definition of "future goods" as defined in section 23 of the Sale of Goods Act, 1930, since the equipment is to be appropriated by the assessee after entering into the contract of sale. The learned counsel agree that as per the provisions of section 23(1) of the Sale of Goods Act property in future goods is transferred to the buyer when the goods are ascertained and when the goods being in a deliverable state are unconditionally appropriated to the contract by the seller with the ascent of the buyer. But, we find that the Assessing Officer has made analysis of the provisions of the Sale of Goods Act and referred to various sections to hold that title of

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goods passed in India. For ready reference, the findings of the Assessing Officer are reproduced as under :

> "Section 19(1) of the Sale of Goods Act provides in a contract for the sale of goods, the property is transferred to a buyer at such time as the parties to the contract intend it to be transferred. However section 19(2) of the Act provides that for the purpose of ascertaining the intention of the parties, regard shall be had to :
>
> (a) the terms of the contract ;
>
> (b) the conduct of the parties ; and
>
> (c) the circumstances of the case
>
> (b) The contract has to be read as a whole to ascertain the intention of the parties.
>
> (c) The definition of these terms clearly indicates that the entire risk is borne by the supplier and carriage and insurance charges paid till their delivery at airport/seaport in India. The repeated reference by the assessee to Incoterms 2000 does not alter the situation because the expression by its very definition in the agreement means the obligation to bear the carriage and insurance charges up to airport/seaport in India. It would be illogical to read that the parties particularly Century Pulp and Paper Company in India, can agree to the delivery at any airport/seaport outside India.
>
> 19.2 In view of all the above referred clauses, if the agreement is read as a whole, the intent of the parties is clear that the title to the equipment passes in India at the site where the deliveries are made or in a worst scenario at the airports/seaports in India.
>
> 19.3 Under the normal circumstances, the risk and title would go together. In the present case, the terms of the agreement read as whole and the conduct of the parties go to indicate that the documents submitted by the assessee during the course of assessment like bill of lading, invoices, import documents, etc., do not demonstrate the true intent of the parties. This condition of the supply cannot be met it. The goods are delivered on high seas. The 'full satisfaction' can be reached only in India after the provisional acceptance. One cannot pick up one part of supply obligation and contend that the title has passed with the discharge of that obligation. Incoterms 2000 only refer to the terms of the agreement generally acceptable between the contracting parties with regard to obligation to bear the cost of transportation, insurance till the point of delivery. Thus, if the agreement is viewed as a whole, it demonstrates that the supplier has the

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obligation to deliver the goods at the relevant site in India and the documents showing that the title passes in high seas does not reflect the actual mode and delivery of the supply nor the true intent of the parties. Section 19(2) of the Sale of Goods Act provides for the factors to determine the intent of the parties and if despite the declaration to the contrary under section 19(1), if it is found as a matter of fact that the deliveries had been made in India it would be open to the Revenue to assert that title to the goods had passed in India.

19.4 Section 21 of the Sale of Goods Act provides that where there is contract for sale of specific goods and seller is bound to do something to goods for the purpose of putting them in a deliverable state the property does not pass until such thing is done and the buyer has notice thereof. In the present case, the sale is not of standard goods but of components of passenger boarding bridges, unless these components are assembled, installed, commissioned and tested, these supplies would be worthless. These components and equipment reached the deliverable state only when their installation is completed and performance established through the provisional or final testing. The assessee has definite obligation to achieve this milestone and unless this is done the property cannot pass. Unlike other kinds of overseas supplies where the supplier has no other obligation beyond the point of shipment, in the present case, the obligation of the supplier extends to the geographical limits of India where he has to put the supply into a deliverable state. In the equipment being discussed in the present case, the various components are integral part of the wholesome technology and these cannot be viewed independently.

19.5 In view of the above, there is no room for any doubt that the title to the goods passed in India despite the declaration in various documents, to the contrary.

Reference is invited to the Sale of Goods Act, section 19(2) and sections 20-24. Section 21 : Specific goods to be put into a deliverable State—Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.

Further, regarding acceptance of goods by buyer—Contract of sale is completed not by mere delivery of goods but by acceptance of goods by buyer. 'Acceptance' does not mean mere receipt of goods. It means checking the goods to ascertain whether they are as per contract.—Where goods are delivered to the buyer which he has not

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previously examined, he is not deemed to have accepted them unless and until he had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract. (section 41(1))

19.6 Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract. (section 41(2))

19.7 It is necessary to decide whether property in goods has been transferred to buyer to determine rights and liabilities of buyer and seller. Generally, risk accompanies property in goods, i. e., when property in goods passes, risk also passes.

19.8 It is seen that title of all equipment sold was to pass from suppliers in high seas before arrival in India but the risk of loss shall pass only upon provisional acceptance by buyer. However, when we examine the terms of the contract, the conduct of the parties and the circumstances of the case. (section 19(2)) it is seen that this is a composite contract of design, manufacture, supply, installation, testing and commissioning of 620 TPD Plant. Therefore the intention of the contracting parties can never be pass the title in high seas.

20. A reading of the aforesaid sections of the Sale of Goods Act will show that where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. This clearly shows that operationalisation and full and guaranteed working condition in accordance with technical 'specifications are the requirements for the contracted goods to be put into a deliverable state and the property does not pass until such thing is done, i. e., working condition as per technical specifications and the buyer has notice thereof though the provisional acceptance. As per terms and conditions of above referred agreements and the discussion in the para above it is amply clear that the assessee was responsible for procurement, transport, receiving, uploading and safe keeping of all the equipment required in the completion of work which include the supply of 620 TPD plant from Austria. In terms and conditions of the agreement, the offshore supplies become the property of the employer only when the same was delivered at site even thereafter the contractor, i. e., the

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assessee continued to bear the risk in respect of such item as the same in its custody till installation, commissioning and testing."

7.15 On a perusal of the list of machinery mentioned in clause 3.1 of the agreement as compared to the machineries imported through various invoices, we find that in the agreement various sections of the plant have been mentioned as machinery. For ready reference, the various machinery mentioned in clause 3.1 of the agreement, as available on page 162 of the paper book is reproduced as under :

"3.1 *Scope of supply*

3.1.1 Supplier shall supply to purchaser the machinery briefly described as below and more fully described in the annexure I,

—Head boxes and forming section

—Press section

—Drying section

—Surface sizing and on-line coating stations

—Air drying system

—Hard and soft nip calendaring

—Pope reel

—Machine control system

—Automation and controls

—Auxiliaries and accessories

—Spares

3.1.2 The SUPPLIER'S scope of supply shall be as specified in annexure I, MACHINERY shall be complete within the delivery limits of SUPPLIER'S scope of supply in order to achieve the performance guarantees subject to the conditions as per annexure III in every respect with all mountings, fittings, fixtures and standard accessories normally provided with such MACHINERY and/or needed for completion and safe operation of the MACHINERY including supports, embedment, etc., as required by the applicable codes, though they may not have been specially detailed in the respective specifications unless included in the list of exclusion. All similar standard components/parts of similar standard equipment provided shall be interchangeable with one another to the extent applicable.

3.1.3 The SUPPLIER shall provide drawing and other data including operation and maintenance manuals as specified in annexures I and IV."

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7.16 The items mentioned in various invoices raised by the assessee on Century Pulp and Paper Company are available from pages 14 to 66 of the paper book. According to the invoices, various components of these machineries have been imported. The sections of the plants as mentioned in the supply agreement have been assembled in India. For example ; the Invoice No. 401400 dated December 9, 2009 available on page 14 of paper book contains various parts of press section in 30 boxes, machine rolls in 5 boxes. Invoice No. 401399 dated December 2, 2009 available on page 19 of the paper book contains various parts of section along with spares packed in 133 wooden boxes. Invoice No. 401391 dated November 19, 2009 available on page 24 of the paper book contains parts of dryer cylinder packed in 24 boxes. Other invoices also contains components of head box, dyer cylinder, wire section, press section, mechanical devices, MCS with power supply, MG-dryer, parts of master reel, coating section, control cabinets, strips for dewatering system, air drying system, MG-hood, hood and ventilation system, hydraulic system, lubrication system, approach flow system, etc. It is evident that items which have been imported through different invoices are not the machineries, which have been mentioned in the supply agreement but these are various components packed in wooden boxes, which have been brought into shape of different section of the plant as listed in agreement, only after assembling at the site of the buyer. After perusal of these invoices, it clear that the goods supplied by the assessee through various invoices are not in deliverable state.

7.17 The learned counsel of the assessee has relied on the decision of the hon'ble Delhi High Court in the case of *DIT* v. *Ericsson A. B.* (supra) to support that acceptance test by the Indian customer was not relevant to hold that the sale effected outside India. The Tribunal in the case of *Shanghai Electric Group Co. Ltd.* has summarised the facts of the *DIT* v. *Ericsson A. B.* [2017-TII-119-ITAT-Delhi-INTL] under :

"In the case of *DIT* v. *Ericsson A. B.* (supra), the facts before the hon'ble Delhi High Court were as under :

'228. The assessee, a Swedish company, entered into contracts with ten cellular operators for the supply of hardware equipment and software. The contracts were signed in India. The supply of the equipment was on CIF basis and the assessee took responsibility thereof till the goods reached India. The equipment was not to be accepted by the customer till the acceptance test was completed (in India). The assessee claimed that the income arising from the said activity was not chargeable to tax in India. The Assessing Officer and the Commissioner of Income-tax (Appeals) held that the assessee had a

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"business connection" in India under section 9(1)(i) and a "permanent establishment" under article 5 of the Double Taxation Avoidance Agreement. It was also held that the income from supply of software was assessable as "royalty" under section 9(1)(vi) and article 13. On appeal, the Special Bench of the Tribunal (*Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269 (Delhi) [SB] held that as the equipment had been transferred by the assessee offshore, the profits therefrom were not chargeable to tax. It was also held that the profits from the supply of software was not assessable to tax as 'royalty'.

229. On appeal to the High Court, the hon'ble court dismissed Revenue's appeal by observing as under :

"(i) The profits from the supply of equipment were not chargeable to tax in India because the property and risk in goods passed to the buyer outside India. The assessee had not performed installation service in India. The fact that the contracts were signed in India could not by itself create a tax liability. The nomenclature of a 'turnkey project' or 'works contract' was not relevant. The fact that the assessee took 'overall responsibility' was also not material. Though supply of equipment was subject to the 'acceptance test' performed in India, this was not material because the contract made it clear that the 'acceptance test' was not a material event for passing of the title and risk in the equipment supplied. If the system did not conform to the specifications, the only consequence was that the assessee had to cure the defect. The position might have been different if the buyer had the right to reject the equipment on the failure of the acceptance test carried out in India. Consequently, the assessee did not have a 'business connection' in India. The question whether the assessee had a "permanent establishment" was not required to be gone into'."

7.18 However, the facts of the assessee before us is not the same as in the case of *DIT* v. *Ericsson A. B.* (supra). In the case of *Ericsson* (supra), the assessee, a non-resident company, supplied the equipment to the operators, while the other two companies (EFC and ECL) were in the business of installations of equipment and granting marketing support to the assessee. All the entities were assessed in respect of the income that accrued to them and it was not the case that only one assessment had to made treating the transaction as one works contract. As against the above facts in the case of *Ericsson* (supra), in the case of the assessee, the assessee alone is responsible for supply of equipment and supervision of installation of equipment. In the case of *Ericsson* (supra), it is held that overall agreement does not result in income accruing in India and execution of the

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overall agreement was prompted by purely commercial considerations. As opposed to the case of *Ericsson* (supra), there was no need for execution of the overall agreement in the case of the assessee because in the case of the assessee both the process of supply and supervision of installation are interconnected as evident from followings :

- Supply and installation are the responsibilities of one party, i. e., the assessee ;
- Description of goods supplied as per invoice (pages 13 to 66 of paper book for the assessment year 2010-11 and pages 143 to 146 of paper book for the assessment year 2011-12) revel that they are only parts of the machinery which need to be assembled, erected and installed. This is consistent with clauses 13.1 and 13.5 of the supply contract which state that machineries to be delivered in part shipments and the date of completion of delivery is the date of delivery of the last consignment ;
- The supply and installation process overlap with each other. The supply of such machine parts continued through both the relevant assessment years alongside installation services. Thus, whereas it is claimed by the assessee that installation services commenced from December 14, 2009 with the arrival of Mr. A. C. Schwab on December 14, 2009 and continued till the assessment year 2012-13, the supply of machine parts continued till at least May 6, 2010 (pages 143 of the paper book for 2011-12. In fact, the value of supplies during the assessment year 2011-12 was Rs. 6,30,75,828. In other words, since as per clause 13.5 of the supply contract, 'the date of completion of delivery is the date of delivery of the last consignment' it can be concluded that the delivery of supply was not completed during the assessment year 2010-11, i. e., the year in which installation activities commenced.
- Moreover, the assessee itself has shown the revenue from installation activities are dependent upon and intrinsically connected with the supply of machinery by offering the income from installation on 'project completion' basis, i. e., after the final 'delivery of the last consignment' of the machinery although, as per the service contract, there was no such obligation on part of the assessee. As per clause 3 of the service agreement, the remuneration was payable at a fixed rate on a per person per man-day basis. The assessee raised its monthly invoices on the above basis and was accordingly remunerated by the client. Yet, the assessee shown such receipts as 'advances' and not recognised as revenue. This is

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another fact which distinguishes the case of the assessee from that of, *Ishikawajima-Harima* and *Ericsson*.

7.19 We find that the hon'ble High Court in the cases of *Ericsson* (supra) held that acceptance test was not a material event for passing of the title and risk in the equipment supplied and if the system did not conform to the specifications, the only consequence was that the assessee had to cure the defect. But there is a caveat attached to the finding that the position might have been different if the buyer had the right to reject the equipment on the failure of the acceptance test carried out in India. In the instant case, the said clause of repayment on return of machinery on failure of acceptance test is available and reproduced above by us. Thus , the decision of the hon'ble High Court in the case of *DIT* v. *Ericsson* in a way support the contention of the Revenue.

7.20 In the instant case, the transit insurance of goods has been arranged by the assessee at its own cost from the warehouse of the supplier to the warehouse of the purchaser, which means the risk in the case of damage of goods during transit remained with the supplier. In such a scenario, article 7.1 that ownership and risk would be transferred to the purchaser, remained only on paper and not acted upon.

7.21 In the instant case the parts of the machineries have been manufactured outside India but they have not been brought in deliverable state in India as per the supply agreement and thus the sale cannot be said as effected outside India. In the case of *Ericsson A. B.* (supra) the contract of erection was executed by the subsidiary company and thus the hon'ble court held that both the entity perform their own independent obligation, receive appropriate separate remuneration and are technically not dependent on each other. But, in the instant case, both the contract of supply and supervision of installation or commissioning of plant has been executed/ supervised by the one party, i. e., the assessee.

7.22 The learned counsel has referred to the decision of *Nokia Networks OY* (supra), where in the Tribunal has held that mere provisioning of marketing activities does not lead to creation of a business connection. The relevant extract is reproduces as under (page 102 of 65 ITR (Trib) :

> "The provisions of section 9(1)(i) of the Act clearly provide that income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be taxable in India if they come within the meaning of income deemed to accrue or arise in India as explained in section 9 of the Act.

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Thus, where any income accrues or arises to a non-resident through or from any 'business connection' in India where all the operations are not carried out in India only such income will be chargeable to tax in India as can be attributed to the operations carried out in India. In light of these provisions and facts of the case, we will analyse the rival contentions of the parties and the judicial proposition highlighted before us in this regard."

7.23 In the instant case, the assessee has not provided the details of marketing activities or negotiation of the contract to the Assessing Officer despite repeated requests and thus, the decision relied upon is any way not assistance to the assessee.

7.24 The hon'ble Andhra Pradesh High Court in the case of *Larsen and Toubro Ltd.* (supra) has relied upon the decision of the hon'ble Supreme Court in the case of *Usha Beltron Ltd.* (supra) wherein various provisions of the Sale of Goods Act, 1930 have been analysed and held that wherever the supply contracts contain and inspection or a certification clause, the title in the goods does not pass till the inspection and certification are successful and the buyer/owner has indicated his approval. The relevant parts of the hon'ble High Court as applicable to the present case are reproduced hereunder (pages 446, 466, 488, 489 and 490 of 88 VST) :

"After extracting sections 3(b) and 5(2) of the Central Sales Tax Act, the assessing authority held that these provisions refer to a 'sale' which is effected by transfer of documents of title while the goods are under movement from one State to another (section 3(b)) . . . *State of Gujarat* v. *Chem-Dyes Corporation* [1991] 83 STC 488 (Guj), the Gujarat High Court had held that during the period, i. e., at the time of endorsement of documents of title to the goods, what was inexistence was an 'agreement to sell', and section 3(b) did not apply. . . .

For a sale to fall under section 3(b), the sale must be effected by the transfer of documents of title to the goods. The transfer of documents, contemplated by section 3(b), is a transfer which, in law, amounts to delivery of the goods. Transfer of documents either by endorsement or delivery completes the transfer of title but, in the absence of an indication to that effect in the statute, the place where the documents are transferred is not necessarily the place of the sale. (*Tata Iron and Steel Co. Ltd.* v. *S. R. Sarkar* [1960] 11 STC 655 (SC)). Transfer of documents of title may be effected by handing them over. An endorsement to that effect on the documents is one mode of proving the fact. (*Dy. CCT* v. *A. R. S. Thirumeninatha Nadar Firm* [1968] 21 STC 184 (Mad) . . .

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. . . . in addition to post-despatch inspection, the supply contracts (as opposed to the erection contracts) also contemplate a certification after erection ; by virtue of the said clause, the owner certifies as to the successful operation of the facility ; the said certification is given after the owner inspects the facility, and finds that all the units and components, which have been supplied, are working ; the scope of certification extends not only to the civil work, but also to the goods supplied under the supply contract ; in all the contracts, the supplier becomes entitled to full payment only upon receipt of such certification ; the payment is linked to successful inspection and certification ; if the contract has an inspection or a certification clause, title does not pass till the inspection and certification are successful, and the buyer/owner has indicated his approval ; the Supreme Court, in *Usha Beltron Ltd.* v. *State of Punjab* [2005] 7 SCC 58, held that title passes only upon certification ; and the petitioners contention that the taking over certificate was merely for ensuring proper quality of goods supplied, and does not relate to passing of property in the goods, is not tenable. . . . .

In *Usha Beltron Ltd.*, the petitioner contended that the property in the goods had passed to the Government of India before it entered the municipal limits ; this was a contract for sale of specific goods in a deliverable state ; the property in the goods passed to the buyer when the contract was made ; and it was immaterial as to what was the time of delivery of the goods. Clause 5.5, of the bid document therein, provided for the issue a taking over certificate when the performance tests had been successfully carried out ; and, while issuance of such a certificate would certify receipt of goods in a safe and sound condition, it would not discharge the supplier of their warranty obligations. Clause 6.1 of the bid document stipulated that delivery of the goods shall be made by the supplier in accordance with the terms of the contract ; and the goods were to remain at the risk of the supplier until delivery was completed. The Supreme Court held that clauses 5.5 and 6.1 of the bid document clearly indicated that the property in the goods remained at the risk of the appellant till delivery was completed ; it showed that delivery would be completed only after the takeover certificate was issued ; as per section 19 of the Sale of Goods Act, the property in the goods passes when the parties intended it to pass ; in this case the contract provided that property in the goods does not pass till after delivery, and after successful testing and issuance of the takeover certificate ; and the High Court was right in

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concluding that the property in the goods had not passed at the time the goods entered the municipal limits. . . . .

Section 23 of the 1930 Act stipulates that title, in a sale of future goods, passes only when the goods are in a deliverable state, they are unconditionally appropriated to the contract, and there is assent of the buyer. If the contract has a post-delivery inspection or a certification clause, the unconditional appropriation, ordinarily, takes place, and the assent of the buyer is also given, only upon inspection and certification. Under section 24 of the 1930 Act title passes upon approval which, in the subject contracts, is only after inspection. The post-delivery inspection clauses in the subject contracts would fall within the ambit of the phrase 'on approval' in section 24 as delivery of the goods is taken only after inspection. The 'taking over' certificate also shows that the buyer indicates his approval only after certification. The inspection and certification clauses in the contract would fall within the ambit of the phrase 'other similar terms' in section 24. The presence of an inspection and certification clause in the supply contract defers passing of title till the owner has expressed its assent. Such assent is given only after inspection and certification . . .

Section 26 stipulates that risk, prima facie, passes with the property and, thereunder, unless otherwise agreed, the goods remain at the sellers risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not. Section 26 is not attracted where the contract provides otherwise. While the question, as to when title to the goods is transferred from the seller to the buyer, must be determined from the conditions stipulated in the subject contracts, if the parties have agreed that the responsibility for risk of loss and damage to the goods would be that of the supplier till erection of the plant is completed, it is evident that transfer of title to the goods was intended to pass only on erection, and not prior thereto.

Section 41(2) of the 1930 Act stipulates that, unless otherwise agreed, when the seller tenders delivery of the goods to the buyer he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract. Section 42 relates to acceptance and, thereunder, the buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them

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which is inconsistent with the ownership of the seller. The post-delivery inspection clauses, in the supply contracts, are in conformity with section 41(2), and the certification clauses therein accord with the requirement of section 42 of the 1930 Act."

7.25 The learned counsel of the assessee tried to distinguish the decisions of the hon'ble Supreme Court in the case of *Usha Beltron Ltd.* (supra) and that of the hon'ble Andhra Pradesh High Court in the case of *Larsen and Toubro Ltd.* (supra) on the ground that the said decisions were delivered in the context of octroi and hence not applicable to the present case. However, the above contentions of the learned counsel are not acceptable since in both the above cases as in the case of the assessee, the issue involved is identical, i. e., place where the title and risk to the property passed for the purpose of tax liability. The only superficial difference if any being that while in the case of *Usha Beltron* the boundary between the taxing jurisdictions was the "municipal limit", in the case of *Larsen and Toubro Ltd.* involved the boundary between "two States" while the present case involves the boundary between "two countries".

7.26 The Revenue also places reliance on the decision of the Income-tax Appellate Tribunal, Delhi in the case of *Shangahai Electronics Group Co. Ltd.* [2017-TII-119-ITAT-DEL-INTL] where the Income-tax Appellate Tribunal held the income from overseas supply to be taxable in India.

7.27 In view of the discussion, we are of the view that the assessee has supplied parts of goods by way of invoices raised, which have further been assembled in India to bring them in deliverable state as agreed in the supply agreement between the assessee and buyer, and thus property in goods have been passed in India and thus part of the consideration of supply agreement for offshore supply is taxable in India. We note that no information has been provided by the assessee in respect of the activity carried out in India subsequent to award of the tender to the assessee for collection of drawing of the factories of the buyer and other input information in relation to erection of plant and customised manufacturing of the parts of various section of the plant.

(b) Business connection in India

The concept of "business connection" basically envisages a relationship 8
between the business carried on by a non-resident yielding profits or gains, on the one hand and some activity in India which contributes to earning of such profit and gains on the other.

8.1 The word "business connection" has been judiciously examined in detail by various courts in the following cases :

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- *CIT* v. *R. D. Aggarwal and Co.* [1965] 56 ITR 20 (SC)
- *CIT* v. *Hindustan Shipyard Ltd.* [1977] 109 ITR 158 (AP)
- *CIT* v. *Atlas Steel Co. Ltd.* [1987] 164 ITR 401 (Cal)
- *CIT* v. *Gulf Oil (Great Britain) Ltd.* [1977] 108 ITR 874 (Bom)

8.2 The ratio decidenci emanating from the aforesaid decision is that the following conditions should exist to constitute "business connection" in India :

- A real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities in India ;
- The relation contributes directly and indirectly to the earnings of income by the non-resident in his business ;
- There should be an element of continuity between the business of the non-resident and the activity in India. To put it apparently, stray or isolated transaction is not normally regarded as a business connection.

8.3 The learned counsel of the assessee has submitted that in support all the aforesaid conditions are conspicuous by their absence in the case of the assessee and therefore, no "business connection" of the appellant could be deemed to exist in India. In support of the same, he invited our attentions to the following submissions :

- The sales were independently made by the appellant to CPP on principal-to-principal basis ;
- The sales were concluded outside India ;
- In connection with the contract in question, no business operations were carried out by the appellant in India.

8.4 In view of the learned counsel of the assessee, income flowing from the contract in question is not liable to tax in India since the appellant does not have any business connection in india, and thus no part of the income can be said to be deemed to accrue or arise in India.

8.5 In *CIT* v. *R. D. Aggarwal and Co.* [1965] 56 ITR 20 (SC), the hon'ble Supreme Court had considered the scope of the expression "business connection", and it was observed as follows (pages 24 and 28) :

> "The expression 'business' is defined in the Act as any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture, but the Act contains no definition of the expression 'business connection' and its precise connotation is vague and indefinite. The expression 'business connection' undoubtedly

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means something more than 'business'. A business connection in section 42 involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in the taxable territories : a stray or isolated transaction is normally not to be regarded as a business connection. Business connection may take several forms : it may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business. In each case, the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case.

A relation to be a 'business connection' must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident. But it must in all cases be remembered that by section 42 income, profit or gain which accrues or arises to a non-resident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profit or gain which accrues or arises or is deemed to accrue or arise within the taxable territories. Income received or deemed to be received, or accruing or arising or deemed to be accruing or arising within the taxable territories in the previous year is taxable by section 4(1)(a) and (c) of the Act, whether the person earning is a resident or non-resident. If the agent of a non-resident receives that income or is entitled to receive that income, it may be taxed in the hands of the agent by the machinery provision enacted in section 40(2). Income not taxable under section 4 of the Act of a non-resident becomes taxable under section 42(1) if there subsists a connection between the activity in the taxable territories and the business of the non-resident, and if through or from that connection income directly or indirectly arises . . . .

The expression 'business connection' postulates a real and intimate relation between trading activity carried on outside the taxable territories and trading activity within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity."

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8.6 In *CIT* v. *Hindustan Shipyard Ltd.* [1977] 109 ITR 158 (AP) a Division Bench of this court had construed the word "business connection". The facts in this case were that : The non-resident company supplied diesel engines with accessories. The terms of the sale were that 90 per cent. of the value must be paid against original set of documents, to be submitted duly to the State Bank of India within fifteen days and the balance within six months. The net price included five per cent. commission payable to the non-resident company at Bombay. The property was to pass to the purchaser on delivery on board. The engine was agreed to be erected by the staff of the purchaser under the supervision of the erector and a supervising engineer was placed at the disposal of the purchaser by the non-resident company.

8.7 It was held that ; "'business connection' can be said to be established when 'the thread of mutual interest runs through the fabric of the trading activities carried on outside and inside the taxable territory and there must be real and intimate connection between the two. The commonness of interest may be by way of management control or financial control or by way of sharing profits'."

8.8 Having regard to the facts of the said case, the hon'ble court held that there was no business connection between the assessee and non-resident company, as the services rendered by non-resident company were connected with the effective fulfilment of the contract of sale and were merely incidental to the contract.

> "The ratio decidendi emanating from the aforesaid decisions is that the following conditions should exist to constitute 'business connection' in India :
>
> • A real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities in India ;
>
> • The relation contributes directly and indirectly to the earnings of income by the non-resident in his business ;
>
> • There should be an element of continuity between the business of the non-resident and the activity in India. To put it apparently, stray or isolated transaction is not normally regarded as a business connection."

8.9 We note that the general provision bringing income from any business connection in India within the scope of section 9(1)(i), has been explained by way of *Explanation 1(a)* of the Act that, in the case of a business of which all the operations are not carried out in India, the income of

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business deemed under this clause to accrue or arise in India. It shall be only such part of income as is reasonably attributable to the operations carried out in India. A careful reading of section 9, together with the *Explanations* thereto, makes it clear that the statutory test for determining the place of accrual of income is not the place where these services are rendered but where those services are utilised.

8.10 Since in the instant case, the part of the operations of the supply agreement have been carried out in India and sale of goods is in continuation of the process of erection of the plant, the conditions of the business connection exits. We have observed an element of continuity between the business of the assessee from supply to successful supervision of the commission of plant. It is not the case of isolated sale of the self goods or stray transaction, in view of the fact that the assessee has rendered supervision of erection/commission of the TPD plant. Thus, the assessee is doing business activities in India which are not isolated instances but represent real and intimate relationship between activities of the assessee done outside India and those done inside India. The business operation being done in India by the assessee are revenue generating as these operations are required to earn the contract and to meet the contractual obligations. Therefore, all parameters of business connection as prescribed by above judicial authorities are satisfied in the case of the assessee. Accordingly, the income is deemed to accrue or arise in India in terms of section 9(1)(i) of the Act from the offshore supply of goods.

Existence of permanent establishment in India

Article 5(1) of the Double Taxation Avoidance Agreement between India and Austria has defined the permanent establishment means a fixed place of through which the business of an enterprise is wholly or partly carried on. The article 5(2) further include following places as permanent establishment : 9

"Article 5. *Permanent establishment*.—(1). . . . .

(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 sales outlet ;

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(h) a warehouse in relation to a person providing storage facilities for others ;

(i) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (for the same or connected project, site or activities) continue for a period of more than six months."

9.1 Article 7(1) of the Double Taxation Avoidance Agreement has further prescribed that profit of enterprise in Austria shall be taxable in India if the Austrian enterprise carries on business in India through permanent establishment situated in India and so much of the profit of the enterprise would be taxable that is attributable to the permanent establishment .

9.2 The assessee has admitted the existence of service permanent establishment in India as far as supervisory activity under the service agreement in view of the fact that the employees of the assessee were stationed at the Century Pulp and Paper Company TPD plant in the year under consideration to supervise the erection and commissioning of the plant.

9.3 The Assessing Officer found that in the tax audit report furnished in form Nos. 3CB and 3CD related to permanent establishment in India for the contract with M/s. Ford India Pvt. Ltd., the address of the permanent establishment was mentioned as "Mohinder Puri and Co. Vandana Building, Tolstoy Marg, New Delhi. He further observed that in the return of income filed by the assessee the same address has been mentioned as the address of the assessee. The Assessing Officer also observed that in the case of the other group of companies of the assessee (M/s. ThyssenKrupp Elevator Austria Pvt. Ltd. and M/s. ThyssenKrupp Airport System SA), the branch/project office has been shown at the same address. According to the Assessing Officer this place was at the disposal of the assessee. In view of the Assessing Officer books of account being maintained on computers systems were located at that place and return of income have been filed for the last many years. The Assessing Officer rejected the contention of the assessee that permanent establishment came into existence after the supply under the impugned contract completed. According to him the place of the business was at the disposal of the assessee for sufficiently long duration and in fact permanent establishment was very much involved in the marketing and pre-contract negotiation done by the assessee. In view of the above observations, the learned Assessing Officer concluded that the assessee had carried out business, supply and supervision of installation, testing and commissioning of machinery for the TPD plant from the permanent establishment of the assessee in India.

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9.4 The learned counsel of the assessee before the Assessing Officer submitted that the activities relating to design and manufacturing were carried out outside India and the Indian permanent establishment of the assessee had no role whatsoever in design, build and manufacturing of the machinery, which is evident from the fact that the assessee-company has no office or manufacturing facilities in India. The learned Assessing Officer rejected the contention of the assessee, observing as under :

> "18.4 The claim of the assessee that the machinery for the TPD plants were delivered outside India in Austria, accordingly no profit from offshore supply could be attributed to the permanent establishment of the assessee in India. I have carefully examined the terms and conditions of the agreement and have noted that the claim of the assessee is factually incorrect. As per the terms and conditions of the agreement the assessee has to deliver the machinery for the TPD plant in running condition after completing supervision of the installation commissioning and testing. In such a condition the assessee's contention that equipment are sold to Century Pulp and Paper Company in high seas cannot be anything but a tax avoidance scheme. When the assessee is required to have possession of the goods at the work site for supervision of installation, the passing of possession in high seas to Century Pulp and Paper Company and again taking it back at the site is highly illogical. No purpose other than tax evasion can be served from this transaction. Further, there is no documentary evidence also of the receipt of these goods by the assessee or its agent at the work site. Even as per section 19(1) of the Sale of Goods Act the title of goods passes when the contracting parties intend it to pass. In this case, when the intention of one of the contracting parties (Century Pulp and Paper Company) is to receive the goods in working condition, the mere documents stating that the title has passed overseas have no value as the nature of goods in this case is such which cannot be imagined to be in working condition high seas. Both these facts are contradicting each other therefore only one of them can be fact. Since the other clauses of the impugned contract are in operation, the title over the goods cannot pass overseas."

9.5 The learned counsel submitted that the supervisory permanent establishment came into existence under the Double Taxation Avoidance Agreement, since the period of stay of employees carrying out supervision activities exceeded the threshold period of six months. It was deemed permanent establishment in India and it does not have any permanent office or commonplace as presumed by the Assessing Officer. According to the

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learned counsel, the activities relating to offshore supply were completed by the assessee-company much before the deemed permanent establishment came into existence. According to him, the Assessing Officer grossly erred in stating that transaction including offshore supply of equipment was done with the involvement of the Indian permanent establishment.

9.6 As regard the address of the "Mohinder Puri and Co." chartered accountants, the learned counsel submitted that the said address was for communication purpose since the said firm was engaged by the assessee for providing professional services related to accounting and taxation and the said firm had no role in the business of the assessee-company. The learned counsel also submitted that the claim of the Assessing Officer that the return of income was being filed in India by the assessee for the last many years was factually incorrect and the assessee had filed the return of income for the first time for the subject assessment year 2010-11.

9.7 On the contrary, on the issue of existence of fixed place permanent establishment, the learned Departmental representative first submitted that the requisite details were not provided before the lower authorities. The submissions of the learned Departmental representative in this regard are reproduced as under :

(i) No details regarding the pre-contract activities and the personnel involved in such activities were furnished despite repeated requests by the Assessing Officer. The Assessing Officer vide letter dated February 22, 2013 asked the assessee to explain "pre-contract details", i. e., how you are chosen for the referred work with reference to the tender modalities". In response, the assessee vide its reply dated March 13, 2013 (page 83 of the paper book) stated that "Regarding the pre-contract details, we are awaiting the same from the assessee. As and when the documents are received, we shall submit the same with your goodself". The assessee again vide its letter reply dated March 19, 2013 sought time on the ground that "In respect of the pre-contract documents, we would like to inform you that the assessee is in the process of collecting the same. However, these are old records, the assessee may take some more time to organise the relevant documents and information. Therefore, we request your goodself to give some more time to the assessee for submitting these details/documents". The assessee, once more vide its reply dated March 25, 2013 (page 91 of paper book) contended that "Regarding the information of the expatriates of the assessee who visited India in respect of the contract with Century Pulp and Paper Mills Ltd. we would like to inform your goodself that due to Easter

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holidays in Austria, the non-resident assessee has not been able to provide the relevant information, as desired by you. However, we expect to receive such information during this week and we hope to file the information with your goodself by the end of this week". It is not the contention of the assessee that no personnel had came to India or involved in the pre-contract and negotiation activities. It accepts that its employees were present in India for pre-contract activities and contract negotiations, but it did not produce these details. No such details were also filed before the learned Dispute Resolution Panel and the final assessment order was passed on January 2, 2014 as per the Dispute Resolution Panel directions dated December 27, 2013.

On the contention of the learned authorised representative that no permanent establishment exist for supply contract he submitted that the assessee consistently claims that it has no fixed place permanent establishment under article 5(1) in India and the supervisory permanent establishment/service permanent establishment came into existence only after the arrival of Mr. Andreas Christian Schwab, site representative on December 14, 2009. The entire attempt by the assessee is to establish that the supervisory permanent establishment being coming into existence after the supplies are made, has no role in the supply of equipment and hence the revenue from supplies cannot be held as connected to it. Despite several opportunities, the assessee preferred not to provide the details of its pre-contract activities in India. Moreover, no other evidences in the form of copies of their passport, etc., were filed in support of the claim that Andreas Christian Schwab, site representative and Hubert Grossman, supervisor stayed in India only between December 14, 2009 and March 31, 2010. As has already been discussed in part B of this submission above, *it is not the contention of the assessee that no personnel had came to India or involved in the pre-contract and negotiation activities. It accepts that its employees were present in India for pre-contract activities and contract negotiations, but it did not produce the details regarding their stay and the functions they carried out in India. On the face of it, it cannot be accepted that Century entered into a high value contract with the assessee without any tender, bidding, negotiations, etc. It is not the claim of the assessee that there is a LO to take care of part of such activities*.

The assessee in its return of income as well as in its TDS returns/ certificates given its address as—

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1 and D, Vandhana Building,
11 Tolstoy Marg,
New Delhi

It may be noted that this address is different from the *site office at Lalkua, Nainital, U. P.* (page 94) which constitutes the supervisory permanent establishment. It cannot be said that the above address at New Delhi is not *a geographically fixed place*. Since as per the tax audit report, (page 34, paper book 2011-12) it has been certified that the *books of account of the assessee are being maintained* at this premises, it cannot be said that the premises are not at the *disposal of the assessee*. It may not be out of context to state that the hon'ble Delhi High Court in the case of *Galileo International Inc.* v. *Dy. CIT* [2008] 19 SOT 257 (Delhi) have upheld the fixed place permanent establishment on the basis of existence of computer terminals. Accordingly, maintenance of books of account at a fixed geographical location satisfies the disposal, location and business tests for the existence of a fixed place permanent establishment. The temporal aspect of the permanent establishment or permanency test is also satisfied as the Assessing Officer in para 18.2 in page 24 of his order has given a finding that "the returns of the assessee are being filed in India since last many years and in all the returns the address of the assessee remains the same". Furthermore, form No. 27A in support of deduction and deposit of TDS (pages 13 and 14 of the submissions of Revenue) shows Mr. C. S. Mathur as the person responsible for deduction and deposit of TDS. Since the said function, i. e., deduction and deposit of TDS can only be carried on by an employee of the assessee payee, it can be concluded that Mr. Mathur is the employee of the assessee who has been operating from the above fixed place of business. Accordingly, the claim of the assessee that the only employees it have in India are Mr. Andreas Christian Schwab and Hubert Grossman is factually incorrect. Both these employees may be the only expat employees present in India, however, on the facts of the case, they are not the Only employees present in India. Thus, the premises at 1A-D, Vandhana Building, 11 Tolstoy Marg, New Delhi constitutes a fixed place permanent establishment of the assessee from which it carries on its business. Furthermore, in the face of non-compliance by the assessee and in the absence of any material to the contrary, the Assessing Officer is justified in treating the same as the fixed place of business of the assessee from which all activities for the supply of equipment taking place.

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9.8 In the rejoinder, the learned counsel submitted that pre-contract activities are not relevant to constitute fixed place permanent establishment. The submission of the learned counsel reproduced as under :

"Re : Constitution of fixed place permanent establishment on account of non-availability of details of pre-contract activities and employee visits Para B (iv) and column 1, pages 1-2 of the learned Commissioner of Income-tax (Departmental representative)'s submission)

The learned Commissioner of Income-tax (Departmental representative) has alleged that the appellant failed to furnish the details of the pre-contract activities despite the same being specifically called for by the Assessing Officer and that no evidence have been furnished in support of the appellant's claim that the employees, i. e., Mr. Andreas Christian Schwab and Mr. Hubert Grossman stayed in India from December 14, 2009 to March 31, 2010 for undertaking supervisory activities. It has been alleged that the subject contract for supply of equipment, being a high value contract, could not have been carried out without any tenders, bidding, negotiations, etc.

Further, the learned Commissioner of Income-tax (Departmental representative) has reiterated the allegation of the Assessing Officer that since the appellant has been maintaining its books of account and filing its income-tax return in India for the past many years, with the address stated as "1A-D, Vandhana Building, 11 Tolstoy Marg, New Delhi", the aforementioned address constitutes fixed place of business from where activities of supply of equipment took place.

Re : Pre-contract activities not relevant to constitute fixed place permanent establishment

As regards the allegation of the learned Commissioner of Income-tax (Departmental representative) with respect to non-furnishing of pre-contract activities before the lower authorities, it is respectfully submitted as under :

The appellant, being a company resident in Austria, is entitled to the treaty benefits under the Double Taxation Avoidance Agreement between Austria and India ("the treaty"). Article 7 of the Treaty dealing with taxation of "business profits", reads 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

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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 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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, and according to the domestic law of the contracting State in which the permanent establishment is situated. However, no such deduction shall be allowed in respect of amounts, if any paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges, for specific services performed or for management, or, except in the case of a banking enterprise by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

(4) No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(5) For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the

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same method year-by-year unless there is good and sufficient reason to the contrary.

(6) Where profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article.'

In terms of paragraph (1) of article 7 of the Treaty, business profits arising to a French enterprise shall be taxable in India, only if the Austrian enterprise has a permanent establishment in India. In other words, in the absence of a permanent establishment in India, no part of the business profits arising to French enterprise is taxable in India.

Article 5 of the treaty defines permanent establishment as under :

'5. *Permanent establishment*.—(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 sales outlet ;

(h) a warehouse in relation to a person providing storage facilities for others ;

(i) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (for the same or connected project, site or activities) continue for a period of more than six months.

(3) 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 connection with, or supplies plant and machinery on hire used for or to be used in the prospecting for, or extraction or exploitation of mineral oils in that State.

(4) Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include :—

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(a) the use off facilities solely for the purpose of storage, display or delivery 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, display or delivery ;

(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 ;

(f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e) provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.'

Paragraph (1) of article 5 of the treaty, which defines the term permanent establishment to mean a "fixed place of business through which the business of an enterprise is wholly or partly carried on", is similarly worded as paragraph (1) of article 5 of the Organisation for Economic Co-operation and Development model convention.

The Organisation for Economic Co-operation and Development commentary on article 5 of the Organisation for Economic Co-operation and Development model convention, states that the following conditions should exist in order to constitute "fixed place of business" for the purpose of paragraph (1) of that article :

- the existence of a "place of business", i. e., a facility such as premises or, in certain instances, machinery or equipment.
- this place of business must be "fixed", i. e., it must be established at a distinct place with a certain degree of permanence.
- the carrying on of the business of the enterprise through this fixed place of business. This usually means that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

It is further submitted that the Double Taxation Avoidance Agreements characterise a fixed place of business as permanent

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establishment only if the enterprise undertakes a business activity through the place of business. This is referred to as the "business activity" test. The 'core business' of the foreign enterprise should be conducted through the place of business. Thus, there should be a nexus between the place of business and carrying on of business.

In order that the foreign enterprise resident of a contracting State can be said to have a fixed place permanent establishment in the other contracting State, it is essential to demonstrate that the foreign enterprise has a fixed place available at its disposal in the other contracting State, which is used for purposes of undertaking core business activities of that foreign enterprise in that other contracting State.

In this regard, reference is made to the decision of the Supreme Court in the case of *Formula One World Championship Ltd.* v. *CIT (I.T.)* [2017] 394 ITR 80 (SC) wherein the court after referring to the Organisation for Economic Co-operation and Development model tax convention, commentaries by Professor Philip Baker and Professor Klaus Vogel, international tax jurisprudence observed that in terms of article 5(1) of the India-UK Tax Treaty, a fixed place permanent establishment is constituted in India, if twin conditions are satisfied, viz., (i) existence of a fixed place of business at the disposal of the foreign enterprise in India ; (ii) through which the business of the foreign enterprise is wholly or partly carried on. In other words, the fixed place of business should be at the disposal of the foreign enterprise through which its business is carried on in India. Conversely, permanent establishment of the foreign company will not be constituted in India where the foreign enterprise is provided access to its customer's premises in order to perform services under the contract with such customer and not for undertaking other business activities of the foreign company in India. The relevant extracts of the decision are as under (page 105 of 394 ITR) :

'32. . . . Some of the instances given by Vogel in this behalf, of relative standards of control, are as under : . . . .

By contrast, in the case of a self-employed engineer who had free access to his customer's premises to perform the services required by his contract, the Canadian Federal Court of Appeal ruled that the engineer had no control because he had access only during the customer's regular office hours and was not entitled to carry on business of his own on the premises . . .

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66. As per article 5 of the Double Taxation Avoidance Agreement, the permanent establishment has to be a fixed place of business "through" which business of an enterprise is wholly or partly carried on. Some examples of fixed place are given in article 5(2), by way of an inclusion. Article 5(3), on the other hand, excludes certain places which would not be treated as permanent establishment, i. e., what is mentioned in clauses (a) to (f) as the "negative list". A combined reading of sub-articles (1), (2) and (3) of article 5 would clearly show that only certain forms of establishment are excluded as mentioned in article 5(3), which would not be permanent establishments. Otherwise, sub-article (2) uses the word "include" which means that not only the places specified therein are to be treated as permanent establishments, the list of such permanent establishments is not exhaustive. In order to bring any other establishment which is not specifically mentioned, the requirements laid down in sub-article (1) are to be satisfied. Twin conditions which need to be satisfied are : (i) existence of a fixed place of business ; and (b) through that place business of an enterprise is wholly or partly carried out.'

It may also be pointed out that the Delhi High Court in the case of *DIT* v. *E-Funds IT Solution* [2014] 364 ITR 256 (Delhi) while deciding the issue as to whether outsourcing of services to an Indian affiliate results in a permanent establishment in India for the foreign company under the provisions of the India-US Tax Treaty held that for the purposes of existence of fixed place permanent establishment under article 5, there must be a fixed place of business at the disposal of the enterprise through which the core business activities of such enterprise are carried out in India. The relevant extracts of the decision are as under (page 307) :

'56. . . . . The fact that business has been transferred or subcontracted or assigned to e-Fund India is not relevant and material, unless we are determining applicability of paragraph 3 to paragraph 5 and the question is whether the Indian company is performing core or auxiliary and preliminary activities. The fact, the report refers to and give details of or number of employees of e-Fund India which are part of the e-Fund group is not relevant. Neither income earned by e-Fund India nor activities in India by the Indian subsidiary by itself, relevant in determining whether or not permanent establishment exists under paragraphs (1), (2), (4) and (5) of article 5. Thus and therefore, the fact that 40 per cent. of the employees of the entire group were in India, i. e., were the employees of e-Fund India, will

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not make the said company agency subsidiary permanent establishment or fixed place permanent establishment of the assessee. Neither provision of any software, intangible data, etc., whether free of cost or otherwise, make e-Fund India an agency or fixed place permanent establishment of the two foreign assessees. Whether or not and on what basis e-Fund India was reimbursed expenses of xerox, courier charges, etc., will not make e-Fund India as permanent establishment of the assessee under articles 5(1), 5(4) or 5(5). Conditions and stipulates under articles 5(1), 5(4) or 5(5) will create a permanent establishment and not the said facts as highlighted in the impugned orders. Therefore, we will now examine the facts found and refer to articles 5(4) and 5(5) of the Double Taxation Avoidance Agreement.'

The aforesaid decision has been upheld by the Supreme Court in *Asst. DIT* v. *E-Funds IT Solution Inc.* [2017] 399 ITR 34 (SC).

To reiterate, fixed place permanent establishment would be constituted if the foreign enterprise has a fixed place available at its disposal in the other contracting State, through which core business activities of such enterprise are carried out. This proposition is reinforced by virtue of the exception carved out in article 5(4) of the Treaty to exclude the use of facilities solely for the purpose of collecting information for the enterprise or for other activities which have a preparatory or auxiliary character.

The provisions of article 5(4) of the Treaty are designed to prevent an enterprise of one contracting State from being taxed in the other contracting State, if it uses facilities solely for the purpose of collecting information for the enterprise or carries on in that other State, activities of a purely preparatory or auxiliary character. It is recognised that the services performed by such a place of business are so remote from the actual realisation of profits, that it is difficult to allocate any profit to the fixed place of business.

The facilities and activities enumerated in the list of exceptions to permanent establishment concept do not constitute permanent establishment, even if all the requirements for constituting fixed place permanent establishment as provided in article 5(1) are otherwise satisfied. The list refers to the activities of a preparatory or auxiliary character, such activities being exempted from permanent establishment taxation.

This Authority for Advance Rulings, in the case of *UAE Exchange Centre LLC, In re* [2004] 268 ITR 9 (AAR), further affirmed by the

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Delhi High Court in *U. A. E. Exchange Centre Ltd.* v. *Union of India* [2009] 313 ITR 94 (Delhi) held as follows (page 17 of 268 ITR) :

'. . . . the word "auxiliary" in common English usage means helping, assisting or supporting the main activity. We have, therefore, to ascertain whether the activities carried on in the liaison offices in India, are only supportive of the main business or form one of the main functions of the business.'

Further, reference is made to the decision of the hon'ble Delhi High Court in the case of *National Petroleum Construction Co.* v. *DIT (I.T.)* [2016] 383 ITR 648 (Delhi) wherein the court held that a building site or an assembly project could be construed as a fixed place of business only when an enterprise commences its activity at the project site. An activity which may be related or incidental to the project but which is not carried out at the site in the source country would clearly not be construed as permanent establishment as it would not comply with the essential conditions as stated in paragraph(1) of article 5 of the Double Taxation Avoidance Agreement. Relevant extracts of the decision are reproduced below (page 674 of 383 ITR) :

'33. In terms of clause (h) of paragraph (2) of article 5 of the Double Taxation Avoidance Agreement, "a building site or construction or assembly project or supervisory activities in connection therewith" would also constitute a permanent establishment of an enterprise subject to that site, project or activity continuing for a period of at least nine months. Clearly, the purpose of the said clause is also to include a building site or a construction or an assembly project as a permanent establishment by itself. On a plain reading, a permanent establishment constituted by a building site or a construction or an assembly project, would commence on the commencement of activities relating to the project or site. The said clause is also to be read harmoniously with paragraph (1) of article 5 of the Double Taxation Avoidance Agreement which necessarily entails a fixed place of business from which the business of an enterprise is carried on. Thus, a building site or an assembly project could be construed as a fixed place of business only when an enterprise commences its activity at the project site. An activity which may be related or incidental to the project but which is not carried out at the site in the source country would clearly not be construed as a permanent establishment as it would not comply with the essential conditions as stated in paragraph (1) of article 5 of the Double Taxation Avoidance Agreement. It is

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necessary to understand that a building site or a construction assembly project doe s not necessarily require an attendant office ; the site or the attendant office in respect of the site/project itself would constitute a fixed place of business once an assessee commences its work at site. Thus, for clause (h) of paragraph (2) of article 5 to be applicable, it is essential that the work at site or the project commences it is not relevant whether the work relates to planning or actual execution of construction works or assembly activities . . . .

37. In the present case, the assessee claims that the survey was conducted by an independent third party engaged by the assessee and that too for a period of nine days in one instance and 27 days in another (from February 27, 2006 to March 7, 2006 and April 25, 2006 to May 21, 2006). The assessee commenced its activities at site when the barges entered into the Indian Territory on November 19, 2006 and such activities relating to the installation, testing and commissioning of the platforms continued till April 27, 2007. Thus, the assessee's activity at site would indisputably commence on November 19, 2006 and continue till April 20, 2007, that is, for a period of less than nine months.'

Reference is further made to the decision of the Delhi Tribunal in the case of *Bellsea Ltd.* v. *Asst. DIT (I.T.)* [2018] 66 ITR (Trib) (S.N.) 29 (Delhi) ; 98 taxmann.com 489 (Delhi-ITAT) wherein the assessee was engaged in the business of dredging and pipeline related services to oil and gas installations. During the year, the assessee was awarded contract for laying of gas pipelines at Krishna Godavari Basin. The scope of work, inter alia, required the assessee to undertake pre-engineering and pre-construction surveys, seabed preparation, etc. The assessee had the single point responsibility towards project management. The Income-tax Appellate Tribunal held that preparatory work for tendering purpose before entering into contract could not be included for determining whether permanent establishment existed in India or not. The relevant extracts of the decision are reproduced below :

'10. From the material placed on record, we find that prior to the entering of the contract, one of the employees of the assessee-company. Mr. Harry Beliaars had visited India sometime in September, 2007 for the purpose of collecting data and information necessary for tendering purpose and to bid for the contract. Before entering into contract with AMC such preparatory work like pre-survey engineering, investigation of site, etc., for tendering purpose without actually entering into the contract and installation of the project cannot be

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held that the activity qua the installation project has started. Here one important fact to establish the threshold period prior to effective date provided in the contract, has neither been brought by the Revenue nor is borne out from the records, that the assessee has installed any kind of project office or developed a site before entering into the contract with the AMC for carrying out any preparatory work. Auxiliary and preparatory activity purely for tendering purpose before entering of the contract and without carrying out any activity of economic substance or active work qua that project cannot be construed as carrying out any activity of installation or construction. Clause (g) of article 5(2) ostensibly refers to activity based permanent establishment, because the main emphasis is on "where such site project or activity continues for a period of more than 12 months". The duration of 12 months per se is activity specific qua the site, construction, assembly or installation project. If the contract would not have been awarded, then any kind of preparatory work for tendering of contract cannot be reckoned for carrying out any activity as stipulated in this clause. Hence, in this case all such preparatory work for tendering purpose before entering into contract cannot be counted while calculating the threshold period. Situation would be different if after the contract/work has been awarded/assigned and then if any kind of active work of preparatory or auxiliary nature is carried out, it could be counted for determining the time period.'

Reference is further made to the decision of the Special Bench of the Tribunal in the case of *Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269 (Delhi) [SB] wherein the Tribunal held that the basic operations to be carried out before the business actually starts such as market survey, industry analysis, economy evaluation, furnishing of product information, ensuring distributorship and their warranty obligation, ensuring technical presentations to potential users, development of market opportunities, providing services and support information, procurement of raw materials and accounting and finance services, etc., are activities of preparatory or auxiliary character before the commencement of actual business in India. Such activities cannot be considered as activities in the course of the carrying on of the business by a foreign company in India and the same are anterior thereto. Relevant extracts of the decision are reproduced below :

'223. The alternative argument of the learned counsel for the assessee was that even if we were to hold that there is a fixed place permanent establishment within the meaning of article 5(1) the

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maintenance of such a fixed place of business was only for "other activities which have a preparatory or auxiliary character, for the enterprise" within the meaning of article 5(3)(e) of the Double Taxation Avoidance Agreement and, therefore, under the negative deeming provisions thereof the office of MINL cannot be deemed to be a fixed place of the assessee's business. Article 5(3) says that "notwithstanding the preceding provisions of this article, the term 'permanent establishment' shall be deemed not to include" the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise. The contention of the assessee is that the activities carried on by MINL for Motorola are of preparatory or auxiliary character. Reliance is placed on clauses (1) to (5) of article 1.1 of the services agreement entered into on April 1, 1996 between the assessee and MINL. The nature of the obligations of MINL have been elaborated in these clauses as under :

"Article 1. *Duties of MINL*

1.1 MINL undertakes the obligation to perform the following services (the 'services') in India to MINC and its affiliated companies (hereinafter referred to jointly as 'Motorola') :

(1) Engage in market survey, industry analysis, economy evaluation, development of business opportunity, investment, joint venture and technology co-operation and interface with potential business partners and with local Government agencies on industrial policy and regulations.

(2) Provide product information and training to distributors and OEMs, assist distributors, to provide potential equipment users with technical and price information, ensure that distributors meet warranty obligations, and maintain technical standards consistent with the high quality, reliability and state of art technology of Motorola equipment, assist distributors to make technical presentations to potential users, act as an interface between Motorola and endusers in dealing with issues of technical performance of equipment, selection of equipment or price of equipment.

(3) Develop market opportunities for Motorola products and services by introducing Motorola products and services and by providing product and service information to potential customers and partners in liaison and support of Motorola and provide warranty and after sales services in connection with the products sold.

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(4) Engage in sourcing and procurement activity on behalf of Motorola for raw materials or components to be incorporated or used in conjunction with products manufactured on a worldwide basis.

(5) Corporate finance and accounting services."

On the basis of above clauses in the services agreement, it is contended that the activities of MINC are only preparatory or auxiliary in character and, therefore, the office of MINL in India cannot be deemed to be a fixed place permanent establishment of the assessee.

224. We see force in the contention, taken in the alternative. The activities described in the clauses of the services agreement do show that they are basic operations to be carried out by MINL before the business actually starts such as market survey, industry analysis, economy evaluation, furnishing of product information, ensuring distributorship and their warranty obligation, ensuring technical presentations to potential users, development of market opportunities, providing services and support information, procurement of raw materials for Motorola and accountings and finance services, etc. These are by all means only activities of preparatory or auxiliary character before the commencement of actual business of Motorola in India. These activities cannot be considered as activities in the course of the carrying on of the business by Motorola in India. but they are anterior thereto . . . .'

Accordingly, pre-contract activities such as pre-engineering survey for the purpose of bidding/tendering are necessary for submitting the bid. At that stage, the bidder is not even certain that the bid would be accepted and the contract would be awarded in its favour. Further such activities do not per se generate any profits particularly since no consideration is paid by the project owner for such activities to the applicant. Accordingly, such activities would at best amount to preparatory or auxiliary activities and the same cannot give rise to permanent establishment of the appellant in India, even if the contract is awarded in its favour since costs for such activities are to be borne by the appellant without any reimbursement and hence, such surveys do not tantamount to any revenue generating activity."

9.9 On the issue whether premises of chartered accountants can be construed as fixed place permanent establishment, the learned counsel in his rejoinder submitted as under :

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"Re : Premises of chartered accountant cannot be construed as fixed place permanent establishment

In this regard, it is respectfully submitted that the aforesaid observation of the Assessing Officer as well as of the learned Commissioner of Income-tax (Departmental representative) that since the appellant has been filing its return of income for the past many years from the aforementioned address (premises of chartered accountant), the same would constitute fixed place permanent establishment, is grossly incorrect inasmuch as the year under consideration, i. e., assessment year 2010-11 was the first year for which return of income was filed by the appellant. As regards the address mentioned in the return of income and form 27A filed by the appellant, it is respectfully submitted that the same belongs to M/s. Mohinder Puri and Co., chartered accountants ('MPCO') who were engaged by the appellant for preparing the books of account and for undertaking tax compliances in respect of onshore activities (supervisory activities) undertaken by the appellant in India. The address of the chartered accountant was mentioned in the return of income and form 27A merely for administrative convenience and to communicate with Indian tax authorities and the chartered accountant firm has no role in the business of the appellant-company. It is respectfully reiterated that the all activities involved in supply of equipment, viz., designing, manufacturing, etc., were carried out outside India and the same were not carried out in India in any manner, much less from the premises of Mohinder Puri and Co.

The aforesaid premises of Mohinder Puri and Co. can, by no stretch of imagination, be construed as a fixed place of business of the appellant in terms of article 5(1) of the India-Austria Double Taxation Avoidance Agreement ('the Treaty') which defines the term permanent establishment (PE) to mean a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'.

As explained earlier, a fixed place of business/permanent establishment is constituted only if the enterprise undertakes a business activity through the place of business. This is referred to as the 'business activity' test. The 'core business' of the foreign enterprise should be conducted through the place of business. (*Formula One World Championship Ltd.* v. *CIT* (supra) and *CIT* v. *e-Funds IT Solutions* (supra)]

Further, reference is made to the decision of the Kolkata Income-tax Appellate Tribunal in the case of *Van Oord Atlanta B. V.* v. *Asst.*

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DIT [2007] 112 TTJ 229 (Kol) wherein the Income-tax Appellate Tribunal, inter alia, held that maintenance of books of account or bank account is irrelevant for determining whether a non-resident has a fixed place of business permanent establishment in India. Relevant extracts of the decision reproduced below :

'9. As regards the merits of the case, we find sufficient force in the arguments of the learned counsel for the appellant. The basic ingredients of a permanent establishment, as indicated in article 5 of the Double Taxation Avoidance Agreement are (i) a fixed place of business, and (ii) carrying on of a business from that fixed place. From the facts available on record it transpires that the appellant did not have any fixed place of business after July 28, 1999 when the dredger left the Haldia Port. After the dredger left the port there was no activity which could be termed as "business carried on" from the "fixed place of business". Maintenance of books of account or bank account cannot be a factor for determines a fixed place of business as permanent establishment. At best, these can be termed as activities of auxiliary character, which have been specially exempted from the definition of permanent establishment in clause 4(e) of article 5.'

In the instant case, it is trite that the address of the chartered accountant was mentioned in the return of income and form 27A merely for administrative convenience and to communicate with Indian tax authorities and the said chartered accountant firm did not play any role in any business activity of the appellant company. Furthermore, the appellant states with full emphasis at its command that the premises of the chartered accountant were never at the disposal of the employees of the appellant through which the business of the appellant was carried on in India. Even otherwise, it is respectfully submitted that maintenance of books of account and filing the income-tax return is a preparatory and auxiliary activity and cannot, in our respectful submission, constitute permanent establishment of the appellant in India.

Be that as it may, as per terms of equipment supply contract, i. e., article 7.1 and the import documents such as bill of lading, etc., it is abundantly clear that the ownership in the goods passed outside India. It is further submitted that the activities relating to design and manufacturing were carried out outside India and the supervisory permanent establishment of the appellant, which came into existence on account of number of days for which appellant's employees stayed in India, had no role whatsoever in the design, fabrication and

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manufacture of the equipment, which is substantiated by the fact that the applicant has no office or manufacturing facilities in India. No evidence has been submitted by the learned Commissioner of Income-tax (Departmental representative) in support of this unsubstantiated, bald allegation which is based wholly on conjectures and surmises. Further, it needs to be appreciated that since the activities relating to offshore supply were completed by the appellant much before the supervisory permanent establishment came into existence, the learned Commissioner of Income-tax (Departmental representative) has grossly erred in stating that all the transactions including offshore supply of equipment were undertaken in India.

In this regard, reference is made to the decision of the Supreme Court in the case of *CIT* v. *Hyundai Heavy Industries Co. Ltd.* [2007] 291 ITR 482 (SC) wherein the assessee foreign company had entered into an agreement with Oil and Natural Gas Company for designing, fabrication, hook-up and commissioning of South Bassein Field Central Complex Facilities in Bombay High. The Supreme Court observed that the act of setting up of permanent establishment triggers the taxability of transactions in the source State ; unless the permanent establishment is set up, the question of taxability does not arise ; in the case of a turnkey project, the permanent establishment is set up at the installation stage while the entire turnkey project, including the sale of equipment, is finalised before the installation stage ; since setting up of permanent establishment is a stage subsequent to the supply of equipment from outside India, income in respect of such supply could not be attributed to tax in the hands of the permanent establishment in India.

The relevant extracts of the decision are reproduced below (page 492 of 291 ITR) :

'On reading article 7 of the CADT, it is clear that the said article is based on Organisation for Economic Co-operation and Development Model Convention. Para (1) of article 7 states the general rule that business profits of an enterprise of one contracting State may not be taxed by the other contracting State unless the enterprise carries on its business in the other contracting State through its permanent establishment. The said paragraph (1) further lays down that only so much of the profits attributable to the permanent establishment is taxable. Paragraph (1) of article 7 further lays down that the attributable profit can be determined by the apportionment of the total profits of the assessee to its various parts or on the basis of an

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assumption that the permanent establishment is a distinct and separate enterprise having its own profits and distinct from GE. Applying the above test to the facts of the present case, we find that profits earned by the Korean GE on supplies of fabricated platforms cannot be made attributable to its Indian permanent establishment as the installation permanent establishment came into existence only after the transaction stood materialised. The installation permanent establishment came into existence only on conclusion of the transaction giving rise to the supplies of the fabricated platforms. The installation permanent establishment emerged only after the contract with ONGC stood concluded. It emerged only after the fabricated platform was delivered in Korea to the agents of ONGC. Therefore, the profits on such supplies of fabricated platforms cannot be said to be attributable to the permanent establishment. There is one more reason for coming to the aforestated conclusion. In terms of paragraph (1) of article 7, the profits to be taxed in the source country were not the real profits but hypothetical profits which the permanent establishment would have earned if it was wholly independent of the GE. Therefore, even if we assume that the supplies were necessary for the purposes of installation (activity of the permanent establishment in India) and even if we assume that the supplies were an integral part, still no part of profits on such supplies can be attributed to the independent permanent establishment unless it is established by the Department that the supplies were not at arm's length price. No such taxability can arise in the present case as the sales were directly billed to the Indian customer (ONGC). No such taxability can also arise in the present case as there was no allegation made by the Department that the price at which billing was done for the supplies included any element for services rendered by the permanent establishment. In the light of our above discussion, we are of the view that the profits that accrued to the Korean GE for the Korean operations were not taxable in India.

12. There is one more aspect to be discussed. The attraction rule implies that when an enterprise (GE) sets up a permanent establishment in another country, it brings itself within the fiscal jurisdiction of that another country to such a degree that such another country can tax all profits that the GE derives from the source country—whether through permanent establishment or not. It is the act of setting out a permanent establishment which trissers the taxability of transactions in the source State. Therefore, unless the permanent establishment is set up, the question of taxability does not arise—whether the transactions are direct or they are through the permanent establishment.

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In the case of a turnkey project, the permanent establishment is set up at the installation stage while the entire turnkey project, including the sale of equipment, is finalised before the installation stage. The setting up of permanent establishment, in such a case, is a stage subsequent to the conclusion of the contract. It is as a result of the sale of equipment that the installation permanent establishment comes into existence."

Reference is further made to the decision of Authority for Advance Rulings in the case of *LS Cable Ltd., In re* [2011] 337 ITR 35 (AAR) wherein it was held that existence of permanent establishment for the purpose of carrying out the contract for onshore supplies and services, etc., had no role to play in offshore supplies ; even if the permanent establishment was involved in carrying on some incidental activities such as clearance from the port and transportation, it could not be said that the permanent establishment was in connection with the offshore supplies. The said decision of the Authority for Advance Rulings has been affirmed by the Delhi High Court in *DIT* v. *L. S. Cable Ltd.* [2016] 243 Taxman 427 (Delhi).

9.10 We have heard the rival submissions of the parties on the issue in dispute. We have considered the contention of the learned counsel that pre-contract activities such as re-engineering survey for the purpose of the bidding/tendering cannot give rise to permanent establishment being activities in the nature of preparatory or of jewellery activities. We have also gone through the decision of the hon'ble Delhi High Court in the case of *GE Energy Parts* [2019-TII-01-HC-Delhi-INTL] cited by the learned Departmental representative. In the said decision the hon'ble court has appreciated contribution of the presale activities, i. e., process of marketing the product, understanding need of client, giving them options about available technology, address queries, etc., by an assessee. The relevant findings of the hon'ble High Court is reproduced as under :

"57. This court is of the opinion that the process of sales and marketing of GE's product through its various group companies, in several segments of the economy (gas and energy, railways, power, etc.,) was not simple. As noticed by the tribunal, entering into contract with stakeholders (mainly service providers in these segments) involved a complex matrix of technical specifications, commercial terms, financial terms and other policies of GE. To address these, GE had stationed several employees and officials : high ranking, and in middle level. At one end of the spectrum of their activities was information gathering and analysis—which helped develop business and commercial opportunities. At the other end was intensive

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negotiations with respect to change of technical parameters of specific goods and products, which had to be made to suit the customers. Standard 'off the shelf' goods—or even standard terms of contract, were inapplicable. In this setting, a potential seller of equipment—like GE, had to create intricate and nuanced platforms to address the needs of customers identified by it, in the first instance. After the first step, of gathering information, GE had to commence the process of marketing its product, understanding the needs of Indian clients, giving them options about available technology, address queries and concerns with respect to technical viability and cost efficacy of the products concerned and—wherever necessary indicate how and to what extent it could adapt its known products, or design parameters, to suit Indian conditions as well as Indian local regulations. This process was time consuming and involved a series of consultations between the client, its technical and financial experts and also its headquarters. Oftentimes the headquarters too had to be consulted on technical matters. After this consultative process ended and the terms of supply were agreed to, the final affirmative to the offer, to be made by the Indian customer, would be indicated by GE's headquarters."

9.11 In instant case, we find that the buyer has not ordered off the shelf machinery, which could be used by the buyer just by plugging of power cords. In this case, the buyer has desired to install a "620 TPD multilayer packaging quoted board plant". The buyer has awarded the contract to the assessee in view of the expertise of the assessee in commissioning of such plant. In addition to the expertise in commissioning of the plant, the assessee is also manufacture of all those components of the machinery, which after assembling at site result into a plant which becomes useful for the buyer. Merely supplying components of machinery may not be of any use for the buyer until all those parts are assembled and commissioned in the form of a plant for manufacturing of the product of the buyer. For the purpose of commissioning of the plant, even after award of tender to the assessee, for making customised machines for the buyer certain data, information or layout plans of premises of the buyer, etc., may be required and then to make designs of the plant. It is unbelievable that after awarding the contract, i. e., June 19, 2008 to the assessee, none has visited site of the buyer prior to dispatch of the goods to the buyer. In the case, the assessee has not provided any detail of either pre-engineering survey/pre-contract activities or any post engineering survey/post contract activities, therefore, we are not commenting on the decisions relied upon by the assessee.

9.12 We do agree with the observation of the Assessing Officer that there was close proximity or connection between the permanent

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establishment and the assessee. The learned Assessing Officer is correct in observing that substantial part of the business activity of the assessee of manufacturing and commissioning of the TPD plant was carried out in taxable territory of the India and supply of parts of machinery for plant was incidental to service contract and for this reason a part of the profit is directly attributable to the permanent establishment in India. In the facts of the case the supervision services are not incidental to sale of the plant and machinery and it is otherwise that for commissioning of the plant, the assessee has brought component of the machinery to India under supply agreement. It is not the case that the assessee is a pure trader or seller of the part of the machineries to be utilised for commissioning of the TPD plant, but the assessee is having domain expertise of commissioning of such plants.

9.13 The existence of service permanent establishment has not be denied by the assessee. In the case of the assessee, the employees of the assessee were in India at the time of entry of the part of the machinery on the Indian soil. Those employees were instrumental in supervising the entire activity of inspection of part of the machinery imported into India and assembling of those machinery to bring into the deliverable state mentioned in the supply agreement. The service permanent establishment has also played the role in completing the supply agreement between the assessee and the buyer. The part of the equipment or the machinery needed for erection or commissioning of the TPD plant though has been manufactured in Austria but same have been utilised for creation of the TPD plant in India. The part of the operations of supply agreement have definitely been carried out in India by the permanent establishment of the assessee and for which part of the profit from the supply agreement also need to be taxed in India in terms of the treaty between India and the Austria as the assessee relied on the treaty provisions for considering taxation of the supply agreement.

Attribution of profit to permanent establishment

In view of the Assessing Officer, the permanent establishment has played role in marketing and related activities and supervision of erection and commissioning, thus, he following the decision of the hon'ble Delhi High Court in the case of *Rolls Royce Plc* v. *DIT (I. T.)* [2011] 339 ITR 147 (Delhi) assigned 35 per cent. of the profit accruing from the offshore supplies to the Indian operations. The Assessing Officer rejected the global consolidated annual account as according to him which included subsidiary companies accounts also. In the absence of a standalone annual accounts, the Assessing Officer adopted profit margin of the company at 9.75 per cent. as was proposed by him in the show-cause notice, and 35 per cent. of

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such profit was attributed to the permanent establishment. The working of the profit attributed to offshore supply, computed by the Assessing Officer is extracted as under :

Particulars	*FY 2009-10 (Rs.)*
Gross offshore supply revenues (INR) = exchange rate @ 70.09	4,72,97,97,680
Profit on the basis of 9.75 per cent.	46,11,55,274
Attribution in India (%)	35%
Total taxable income	16,14,04,346

10.1 Before us, the learned counsel of the assessee submitted that as per global accounts there was a net loss of 7.96 per cent. whereas the Assessing Officer has arbitrarily applied FAR analysis and benchmarking companies while computing the profit attributable. He further submitted that no basis has been given by the Assessing Officer to allocate profit of the company assigned to the Indian permanent establishment and the percentage of 35 per cent. adopted by the Assessing Officer is arbitrary without any rational. He submitted that in the case of *Rolls Royce Plc.* (supra), sale of goods was through the liaison officer, i. e., RRIL and it was remunerated for it. He submitted that RRIL carried out marketing activities in India on behalf of the Rolls-Royce PLC. According to the learned counsel, however, in the instant case, two separate contracts have been awarded to the assessee-company by the Century Pulp and Paper Company and there was no permanent establishment at the time of signing of the contract. According to him the deemed "permanent establishment" came into existence by virtue of rendition of the supervision services and therefore attribution of 35 per cent. of the profit from supply of the equipment based on the decision in the *Rolls Royce Plc.* (supra) was not justified as the company did not carry out any licensing or marketing activities in relation to supply of the equipment India.

10.2 Alternatively, in support of the ground No. 3(o), the learned counsel submitted that only 10 per cent. of the global profit is applied to India sales could be best attributed as profit to the alleged permanent establishment. The relevant submissions in support of ground are reproduced as under :

"*Re : Grounds of Appeal Nos. 11 and 12 : Attribution of profits*

Without prejudice to the aforesaid, only a small part of the global profits of the appellant-company could, if at all, be attributed to the permanent establishment of the appellant in India and can be

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brought to tax in India as substantial and substantive part of the appellant's activities are carried outside India.

The principle of attribution has been upheld by the hon'ble Supreme Court of India in the case of *CIT* v. *Ahmedbhai Umarbhai and Co.* [1950] 18 ITR 472 (SC). The court observed that where a person is carrying on manufacture and sale, the profits received relate firstly to his business as manufacturer and secondly, to his trading operations. Profit or loss has to be apportioned in a business-like manner and according to well established principles of accountancy. In such cases, the court held that it will be doing no violence to the meaning of the words 'accrue or arise' if the profits attributable to the manufacturing business are said to arise or accrue at the place where the manufacture is being done and the profits which arise by reason of sale are said to arise at the place where the sales are made.

The aforesaid view was reiterated by the hon'ble Supreme Court in the case of *Anglo-French Textile Co Ltd.* v. *CIT* [1954] 25 ITR 27 (SC). It was observed in the aforesaid case that though profits may not be realised until the manufactured article is sold, profits are not wholly made by the act of sale and do not necessarily accrue at the place of sale. It was further observed that to the extent profits are attributable to the manufacturing operations, profits accrue at the place where the business operations are carried on. The question whether a particular part of income, profit or gain arose or accrued within the taxable territories or without the taxable territories would have to be decided having regard to the general principles as to where the income, profit or gain could be said to arose or accrue, the court held.

In the aforesaid case, the assessee-company incorporated in the United Kingdom and having its registered office in London manufactured yarn and cloth in their mill at Pondicherry. The assessee had appointed a company in Madras at their agents. The manufactured goods were sold mostly in British India and partly outside British India. All the contracts in respect of the sales in British India were entered into in British India and deliveries were made and payments were received in British India. In regard to sales outside British India also, payments in respect of such sales were received in Madras through the agents.

The assessee had shown the total world income for the year ended December 30, 1941 at Rs. 10,23,807. Profit at 10 per cent on British Indian sales which aggregated to Rs. 57,07,431 was shown at Rs. 5,70,743 and after deduction of the proportionate expenses relating to sales in British India and sundry charges was put down at

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the net figure of Rs. 4,58,026 which was shown as the British Indian income. It was, thus contended that the income arising in British India in the year of account did not exceed its income arising without British India and that, therefore, the assessee was non-resident in British India. This calculation of profits, at the rate of 10 per cent. on British Indian sales did not make any allocation between manufacturing profits and merchanting profits and all the profits arising out of British Indian sales were shown in one lump sum.

It was held on the aforesaid facts, that the income received in British India could not be said to wholly arise in British India and that there should be allocation of income between the various business operations of the assessee demarcating the income arising in the taxable territories in the particular year from the income arising without the taxable territories in that year.

The Madras High Court in the case of *Annamalais Timber Trust and Co.* v. *CIT* [1961] 41 ITR 781 (Mad), held that the apportionment of profits under the above provisions should not be arbitrary but on a rational basis. Where the only operation within the taxable territory was the negotiation and conclusion of the contract, there was no justification for apportioning 50 per cent. of the profits to the operation carried out within the taxable territory. The court held that there was justification only for apportioning 10 per cent. of the assessee's share of the profits to the trading operations carried out in the taxable territory.

The decision of the Calcutta High Court in the case of *CIT* v. *Bertrams Scott Ltd.* [1987] 31 Taxman 444 (Cal), where the court upheld the order of the Tribunal is directly to the point under consideration. In that case the Tribunal had noted that a large number of services were to be performed outside India as compared to the comparatively fewer services rendered in India. The court upheld the estimated 10 per cent. of the net profits as income accruing or arising in India.

Your honour's kind attention in this regard is further invited to decision of the Special Bench of the Tribunal in the case of *Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269 (Delhi) [SB], wherein the Tribunal elaborated the manner in which the profit attributable to the permanent establishment, are to be computed.

In that case, the assessee engaged in the business of telecom equipment supply and erection, was held to have a permanent establishment in India, through which the activities relating to telecom network planning, negotiations relating to sale of equipment and signing of supply and installation contracts with Indian customers, were carried out in India. The issue before the Special Bench was, as to

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what was the income attributable to the permanent establishment of the assessee in India. The Special Bench found that the assessee made global net profit of 10.8 per cent. The aforesaid percentage was applied to the sales made to the Indian customer, and the resultant figure was held to be net profit arising in respect of the Indian sale. Having regard to the activities of the permanent establishment in India, 20 per cent. of the net profit in respect of the Indian sale was held to be income attributable to the permanent establishment in India.

Reliance is further placed on the recent decision of the Uttarakhand High Court in the case of *Samsung Heavy Industries Co. Ltd.* v. *DIT (I.T.)* [2017] 10 ITR-OL 673 (Uttarakhand) ; 265 CTR 109 in judgment dated December 27, 2013. The observation of the court on the issue of attribution of income reads as (page 676 of 10 ITR-OL) :

'In paragraph (1) of article 7 of the said agreement, it has been provided that 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. It, therefore, recognises two tax identities of an enterprise. The said paragraph makes it clear that the profits of the enterprise may be taxed in the other State only so much of the same which is attributable to that permanent establishment.

Paragraph (2) of article 7 is as follows (see [1987] 165 ITR (St.) 191) :

"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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."

In the event, an enterprise having a tax identity in one contracting State for having a permanent establishment there, and dealing wholly independently with its other tax entity situate in the other contracting State, the profit attributable to the first tax identity will be profit which might be expected to be made.

Therefore, the said agreement does not give any guidance to ascertain what income is attributable to which tax entity unless profit is generated by one tax entity dealing with the other tax entity.

In the instant case, the appellant held out that a part of the money received by it was attributable to within India activities and

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the remaining on account of out of India activities. The appellant was not generating any revenue by dealing with either its Indian tax identity, or its Korean tax identity. It was generating revenue by dealing with O.N.G.C. under the said contract. It confessed that a part of such revenue was earned by it for having had carried out within India activities. It asserted and continues to assert that the remaining revenue was generated by carrying out of India activities. There is no finding anywhere that the revenue earned and said to have been on account of out of India activity was earned, in fact, on account of within India activity.

Being a resident of Korea, the appellant is governed by the income-tax laws applicable to the class of assessees as that of the appellant as prevalent in Korea. Therefore, it has a tax identity in Korea. In addition thereto, the appellant has submitted to the jurisdiction of Indian taxing authorities by furnishing return of income and, thereby, acknowledged that it has also a tax identity in India. The question is, this identity is covered by which provision of the agreement. In terms of paragraph (1) of article 7, the appellant will acquire its tax identity in India only when it carries on business in India through a permanent establishment situated in India. By submitting the return, the appellant has held out that it is carrying on business in India through a permanent establishment situated in India. In the circumstances, the contention of the appellant, whether the project office of the appellant opened at Mumbai can be, or cannot be said to be a permanent establishment within the meaning of the said agreement is of no consequence. In terms of the said agreement, as it appears to us. if an enterprise does not have a tax identity in India in the form of a permanent establishment, it has no obligation to either submit any tax return with, or pay any tax to India. The question still remains, whether it was right on the part of the taxing authority to assess income-tax liability of the appellant as was assessed in the instant case. In other words, can it be said that the agreement permitted the Indian taxing authority to arbitrarily fix a part of the revenue to the permanent establishment of the appellant in India ? As aforesaid, the appellant held out that a part of the revenue was received by it for doing certain work in India. It did not contend that even those works were done by or through its project office at Mumbai. On the other hand, there is not even a finding that 25 per cent. of the gross revenue of the appellant was attributable to the business carried out by the project office of the appellant. One has to read article 5 of the agreement in order to understand what a per-

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manent establishment is, in terms whereof "permanent establishment" means a fixed place of business through which business of an enterprise is wholly or partly carried on. In the instant case, according to the Revenue, the project office of the appellant in Mumbai is the "permanent establishment" of the appellant in India through which it carried on business during the relevant assessment year and 25 per cent. of the gross receipt is attributable to the said business. Neither the Assessing Officer, nor the Tribunal has made any effort to bring on record any evidence to justify the same.

That being the situation, we allow the appeal, set aside the judgment and order under appeal as well as the assessment order in so far as the same relates to imposition of tax liability on the 25 per cent. of the gross receipt upon the appellant in the circumstances mentioned above, and observe that the questions of law formulated by us, while admitting the appeal, have not, in fact, arisen on the facts and circumstances of the case, but the real question was, whether the tax liability could be fastened without establishes that the same is attributable to the tax identity or permanent establishment of the enterprise situate in India and the same, we think, is answered in the negative and in favour of the appellant.' (emphasis supplied).

Reliance in this regard is placed on the decision of the Delhi Bench of the Tribunal in the recent case of *Convergys Customer Management Group Inc.* v. *Asst. DIT (IT)* [2013] 26 ITR (Trib) 443 (Delhi) (I. T. A. Nos. 1443/Delhi/2012 and 5243/Delhi/2011). In that case, the assessee was an American company engaged in providing IT enabled customer management services. The assessee had established a subsidiary in India which provided back office/call centre services to the assessee to services its customers in India. The Tribunal held that the Indian company constituted permanent establishment of the assessee in India since the assessee exercised substantial control and influence in the functional matters as is evident from the frequent and extensive visits of the assessee's employees to India, secondment of the assessee's employees to the key position in the Indian company and considering that the Indian company did not bear any substantial risk in relation to the functions carried out by in India. The hon'ble Tribunal while explaining the approach of computing profits attributable to such permanent establishment, held as under (page 492 of 26 ITR (Trib) :

'In view of the above facts, circumstances, case law, Central Board of Direct Taxes circulars and various articles of India-USA Double Taxation Avoidance Agreement, following conclusions are arrived at :

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A. . . . . .

F. In our considered opinion, the correct approach to arrive at the profits attributable to the permanent establishment should be as under :

Step 1 : Compute global operating income percentage of the customer care business as per annual report/10K of the company.

Step 2 : This percentage should be applied to the end-customer revenue with regard to contracts/projects where services were procured from CIS. The amount arrived at is the operating income from Indian operations.

Step 3 : The operating income from India operations is to be reduced by the profit before tax of CIS. This residual is now attributable between US and India

Step 4 : The profit attributable to the permanent establishment should be estimated on residual profits as determined under step 3 above. The attribution of India profit shall be worked out as under, mentioned after the table :

In the computation based on the above approach for the assessment year 2006-07, the profits attributable to India comes as under :

Particulars	*Amount (in USD)*
Total revenue of CMG as per the annual report (A)	1,663,600,000
Operating income of CMG as per the annual report (B)	175,500,000
Operating income as a percentage of revenue earned (C = B/A)	10.55%
End-customer revenue from Indian operations (D)	138,900,000
Operating income from Indian operations (E = C * D)	14,653,950
Operating income of CIS (Profit before tax of CIS) (F)	13,800,000
Profit retained by CMG in the US (G = E - F) Placitum "X"	853,950

As per this working, the worldwide profit earned by CMG for the assessment year 2006-07 comes to USD 853950. This by and large tallies with the submission of the assessee dated December 26, 2010 to the Assessing Officer in which it has been submitted that the approximate operating profits of CMG in USD come to 0.8 million. Now the important question that arises is as to how much of the profits shall be attributable to CMG's Indian permanent establishment over and above the profits declared by its subsidiary CIS.

Apropos the Transfer Pricing Officer's estimation, we are of the view that the same is not justified as it involves a very unrealistic method of counting the worldwide number of employees and divid-

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ing it with CMG's global revenue without considering the relevant aspects. The finer and material aspects about the status, capacity of the employees are over looked and result become very vague and distorted. Therefore, the method adopted by the Assessing Officer cannot be relied on as the most appropriate method.

Apropos the Commissioner of Income-tax (Appeals)'s estimate about attribution, though he accepted the proposition that there cannot be notional addition to India revenue, however, the Commissioner of Income-tax (Appeals)'s method also does not become a rational inasmuch as the various expenditures incurred by CMG, i. e., research and development, depreciation, amortisation, etc., have not been considered and 50 per cent. of selling, general and administrative expenses have been ignored along with other expenses incurred by CMG outside India for earning the revenue from end customers. In our considered view, this approach is also not viable and appropriate.

As the methods for calculating the attribution profit as adopted by the Transfer Pricing Officer and the Commissioner of Income-tax (Appeals) are not reliable. The learned counsel has further demonstrated that if both the methods are harmoniously applied, this leads to a situation where no further attribution to the assessee's income can be made. Thus a harmonious intermixed rationalisation of the Transfer Pricing Officer and the Commissioner of Income-tax (Appeals) method results into no further attribution of profits to the Indian permanent establishment.

In this backdrop we are reminded of two case law decided by the hon'ble Supreme Court which have dealt with attribution of the profits to the Indian permanent establishments :

(i) *Anglo-French Textile Co. Ltd.* v. *CIT (No. 2)* [1953] 23 ITR 101 (SC), in which 10 per cent. attribution has been held to be reasonable.

(ii) *Hukum Chand Mills Ltd.* v. *CIT* [1976] 103 ITR 548 (SC), in which 15 per cent. attribution has been held to be reasonable.

These cases decided by the apex court though are old, but they still hold the field as they have not been tinkered with. In our considered view, the adoption of higher figure of 15 per cent. as held by the hon'ble Supreme Court in the *Hukum Chand Mills Ltd.* (supra), for attribution of the assessee's Indian permanent establishment operations will meet the ends of justice. Thus, the attribution of Indian permanent establishment income should be made at 15 per cent. of profit retained by CMG in the US.

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In other words, 15 per cent. of the placitum X (result of G=E-F) in the chart at para 117, as mentioned above as a reasonable attribution of profit of India permanent establishment, will meet the ends of justice. Thus, the Assessing Officer will work out the profits attributable to Indian permanent establishment on this method for the assessment year 2006-07." (emphasis supplied)

On a rough and ready basis, in the present case, since the alleged permanent establishment is involved in lesser number of activities, only 10 per cent. of global profit percentage as applied to India sales could at best be attributed as profit attributable to the alleged permanent establishment, as held in the following cases :

• *Anglo French Textile Co. Ltd.* v. *CIT* [1953] 23 ITR 101 (SC)
• *CIT* v. *Bertrams Scott Ltd.* [1987] 31 Taxman 444 (Cal)

In the present case, it may be pointed out that since the appellant has incurred as loss at the global/head office level, therefore, no portion of its global receipts can be attributed to tax in India'."

10.3 We have heard submission of the parties on the issue in dispute. We find that the assessee has not provided any detail in respect of the marketing or pre-tendering activities or even post-tendering activity. In the absence of any such details, it was difficult for the Assessing Officer to quantify the role related to marketing activity played by the permanent establishment. But as far as the assembly of fabrications of the machines the service permanent establishment has played a significant role and no part of the profit out of the supply agreement has been assigned by the assessee towards the service permanent establishment. In the supply agreement, the assessee has supplied mainly parts or the components of the machines and those machines or sections of the plants have been assembled in India. As we have already concluded that for all practical purposes the property in goods transferred in India and thus permanent establishment has played a role in supply agreement other than design, build and manufacturing of the components of the machines. Therefore, the significant part of the profit on offshore supply of equipment under the supply agreement need to be attributed to permanent establishment in India. In the case of the *Rolls Royce Plc*. (supra), the hon'ble High Court taken into consideration the role 50 per cent. towards manufacturing activity and 15 per cent. towards the research and development activity and balance 35 per cent. was considered to the marketing activity. The relevant finding of the hon'ble High Court is reproduced as under :

"In the *Rolly Royce's* case, the assessee was a British company. It supplied certain parts and equipment to Indian customers. Rolls Royce India Limited ('RRIL') was 100 per cent. subsidiary of the

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assessee set up in India, which rendered liaison services and was remunerated on a cost plus basis. The Assessing Officer, after holding that Rolls Royce India Limited was permanent establishment of the assessee and there was business connection between the two as the marketing and sale of goods to Indian customers were carried out by the assessee through Rolls Royce India Limited, held that profits attributable to permanent establishment were liable to tax in India in terms of article 7 of the Double Taxation Avoidance Agreement between India. The Assessing Officer, accordingly, invoked rule 10 of the Income-tax Rules, 1962 and attributed 100 per cent. of profits earned from sale of goods to Indian customer in the assessment years 1997-98 to 2000-01 and 75 per cent. of profits in the assessment years 2002-03 and 2003-04. On appeal, the Commissioner (Appeals) upheld the order of the Assessing Officer for the assessment years 1997-98 to 2000-01 and held that the offices of the Rolls Royce India Limited in India constituted permanent establishment of the assessee in India under article 5 of the Double Taxation Avoidance Agreement. However, he modified the order of the Assessing Officer to the extent that the profits attributable to the activities carried on in India were deemed to be 75 per cent. instead of 100 per cent. of the estimated profits as held by the Assessing Officer.

On second appeal, the Tribunal modified the order of the Commissioner (Appeals) to the extent that the profits attributable to the activities carried on in India were estimated at 35 per cent. instead of 75 per cent. as held by the Commissioner (Appeals). The Tribunal held that out of the total profits on global basis, 50 per cent. of the profit was to be attributed to the manufacturing activity, 15 per cent. to research and development activities and balance to marketing activities and since marketing activities were carried out in India, to the extent of sales in India proportionate profit was to be attributed to the global profits. The contention of the assessee that net research and development expenses should also be reduced while computing operating profits was rejected by the Tribunal on the ground that no part of research and development activities was carried out in India. The hon'ble Delhi High Court dismissed the assessee's appeal against the percentage of attribution.

In can be seen from the above case that there was sale of goods through the liason office, i. e., Rolls Royce India Limited and it was remunerated for it. Further, Rolls Royce India Limited carried out marketing activities in India on behalf of Rolls Royce PLC. However, in the instant case, two separate contracts have been awarded to the

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appellant-company by CPP and there was no permanent establishment at the time of signing of the contracts. The deemed permanent establishment came into existence by virtue of rendition of supervision services. Accordingly, attribution of 35 per cent. of the profits from the supply of equipment based on the decision in *Rolls Royce Plc*. (supra) is unjustified as the appellant-company did not carry out any liasoning or marketing activities in relation to the supply of equipment in India."

10.4 In the instant case, in addition to the marketing activities or engineering survey pre or post-awarding of contract (for which no information has been filed by the assessee), the service permanent establishment has played a role in assembling and bringing the equipment to deliverable state as agreed under the supply agreement. In such facts and circumstances, in our opinion, the 35 per cent. of the profit attributed to the permanent establishment is justified. Accordingly, we uphold the same.

11 Ground No. 4 of the appeal relates to interest as under section 234A/234B/234D of the Act. The learned counsel of the assessee has submitted as under :

"*Re : Ground of appeal No. 13—No interest chargeable under section 234B of the Act*

At the outset, it is submitted that since the revenues receivable by the appellant are subject to deduction of tax at source, the question of payment of advance tax and subsequent levy of interest under section 234B of the Act does not arise at all, as elaborated hereunder :

As per the provisions of section 234B of the Act, an assessee who is liable to pay advance tax under section 208 will be liable to interest under the said section, if he fails to pay such tax, or the advance tax paid by him falls short of 90 per cent. of the assessed tax. Accordingly, before levying interest under section 234B, it must be first determined whether the assessee was liable to pay advance tax under the provisions of section 208 of the Act.

In terms of section 208 read with section 209(1)(d) of the Act as applicable at the relevant time, advance tax payable has to be computed after reducing from the estimated tax liability, the amount of tax deductible/collectible at source on income which is included in computing the estimated tax liability. Such balance tax liability is the advance tax payable under section 208 of the Act. It should be noted that the words used in section 209(1)(d) of the Act are 'tax deductible at source' and not 'tax deducted at source'.

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Under section 195 of the Act, tax is deductible at source from payments made to non-residents. The appellant being a non-resident, tax is deductible at source under section 195 of the Act from the payments made to the appellant. Since tax was deductible at source on all the payments made to the appellant, no advance tax was payable as per the provisions of section 208 read with section 209(1)(d) of the Act. In the absence of any liability for payment of advance tax, the provisions of section 234B of the Act for alleged short payment of advance tax cannot apply and the levy of interest hereunder should be deleted.

Reliance is placed on the recent decision of the Delhi High Court in the case of *DIT (IT)* v. *GE Packaged Power Inc.* [2015] 373 ITR 65 (Delhi) (I. T. A. Nos. 352-353 of 2014), wherein the High Court held that no interest under section 234B of the Act could be levied on the assessee-payee on the ground of non-payment of advance tax because the obligation was upon the payer to deduct the tax at source before making remittances to the non-resident assessee. The relevant extracts of the decision are reproduced hereunder (page 86 of 373 ITR) :

'This court, therefore, holds that *Jacabs* (supra) applies in such situations ; *Alcatel Lucent* (supra) can be explained as a decision turning upon its facts ; its seemingly wide observations, limited to the circumstances of the case. This court, therefore, holds that the view taken by the Income-tax Appellate Tribunal was correct ; the primary liability of deducting tax (for the period concerned, since the law has undergone a change after the Finance Act, 2012) is that of the payer. The payer will be an assessee in default, on failure to discharge the obligation to deduct tax, under section 201 of the Act.

For the above reasons, this court finds that no interest is leviable on the respondent-assessees under section 234B, even though they filed returns declaring nil income at the stage of reassessment. The payers were obliged to determine whether the assessees were liable to tax under section 195(1), and to what extent, by taking recourse to the mechanism provided in section 195(2) of the Act. The failure of the payers to do so does not leave the Revenue without remedy ; the payer may be regarded an assessee-in-default under section 201, and the consequences delineated in that provision will visit the payer. The appeal of the Revenue is accordingly dismissed without any order as to costs.'

Further, reliance is placed on the following decisions of the courts/ tribunals, wherein it has been held that interest under section 234B of the Act for non-payment of advance tax could not be levied on the

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non-resident assessee, since such assessee was not liable to pay any advance tax considering that all payments made to the assessee were subject to tax deduction at source even if the payer had not actually deducted tax at source :

- *DIT* v. *Maersk Co. Ltd.* [2011] 334 ITR 79 (Uttarakhand).
- *DIT* v. *Jacabs Civil Incorporated* [2011] 330 ITR 578 (Delhi)
- *Sedco Forex International Drilling Inc* v. *Dy. CIT* [2000] 72 ITD 415 (Delhi)
- *Asia Satellite Telecommunications Co. Ltd.* v. *DIT* [2011] 238 CTR 233 (Delhi)
- *Rheinbraun Engineering and Wasser GmbH* [1915/Bom/96]

It may be pointed out that the Finance Act, 2012, with effect from April 1, 2012 added a proviso below section 209(1) of the Act to the following effect :

'Provided that for computing liability for advance tax, income-tax calculated under clause (a) or clause (b) or clause (c) shall not, in each case, be reduced by the aforesaid amount of income-tax which would be deductible or collectible at source during the said financial year under any provision of this Act from any income, if the person responsible for deducting tax has paid or credited such income without deduction of tax or it has been received or debited by the person responsible for collecting tax without collection of such tax.'

The said proviso is applicable from the assessment year 2013-14 and is, therefore, prospective in operation. The insertion of the proviso cannot be construed to have retrospective effect so to expose a non-resident company to levy of interest under section 234B of the Act for assessment years prior to the assessment year 2013-14, where tax was deductible at source on the income payable to the non-resident, if such income is held to be chargeable to tax in India."

11.1 The learned Departmental representative, on the other hand, submitted that it was the responsibility of the assessee to pay the advance tax on its income, if tax was not deducted by the deductor, and accordingly, the Assessing Officer is justified in levy of interest under section 234B of the Act.

11.2 We have heard the rival submissions of the parties on the issue in dispute. The learned counsel has submitted that the proviso below section 209(1)(d) of the Act is prospective in nature. The learned counsel has also relied on the decision of the hon'ble Delhi High Court in the case of *DIT* v. *GE Packaged Power Inc.* (supra). The hon'ble High Court has

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observed that in view of the change after the Finance Act, 2012 it was primary liability of the payer to deduct tax and he would be an assessee-in-default, on failure to discharge the obligation to deduct tax under section 201 of the Act. But the instant case is prior to the amendment or change brought by the Finance Act, 2012. In the case of *DIT (IT)* v. *Alcatel Lucent World Services Inc.* (I. T. A. Nos. 326, 329 and 336 of 2012) [2014] 2 ITR-OL 276 (Delhi) the hon'ble Delhi High Court has reproduced facts of the case as under (page 281) :

> "The Assessing Officer however did not accept the assessee's stand and in the assessment order passed on March 23, 2010 attributed 2.5 per cent. of the sale proceeds of the hardware as profit attributable to the permanent establishment in India, which came to Rs. 21,02,58,238 for the assessment year 2007-08. Similar reassessments were made in all the years in respect of both the assessees. In the reassessment order, in addition to the aforesaid income, the Assessing Officer also directed that interest under sections 234A, 234B and 234C shall be charged. Demand notices were accordingly issued.
>
> Appeals were taken by the assessee in respect of all the assessment years before the Commissioner of Income-tax (Appeals). Three grounds were taken in the appeals. The first ground was that the Assessing Officer erred in computing the income of the assessee as was done in the reassessment orders ; the second ground was that on the facts and in the circumstances of the case and in law, the Assessing Officer erred in levying interest under section 234B, in view of the fact that the entire consideration in the hands of the appellant was subject to deduction of tax at source under section 195 of the Act' ; the third ground was against the initiation of penalty proceedings for alleged concealment of income.
>
> Before the Commissioner of Income-tax (Appeals), the assessee did not press the appeals in respect of the first ground, i. e., the ground against the computation of the income attributable to the permanent establishment in India. Only ground No. 2 which was directed against the levy of interest under section 234B of the Act was pressed, the contention being that it was the liability of the purchasers of the telecom equipment in India to deduct income-tax at the applicable rates from the remittance made to the assessee under section 195 of the Act, that in view of the language employed in section 209(1)(d) the assessee was entitled to take credit for the tax which was 'deductible' at source while computing its liability for paying advance tax and if the amount of tax so 'deductible' by the payer in

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India is given credit, there was no amount of advance tax payable by the assessee, and if that is so there was no question of the assessee being liable to pay any interest under section 234B. Several authorities were cited before the Commissioner of Income-tax (Appeals) in support of the above contention including the judgment of a Division Bench of this court in *DIT* v. *Jacabs Civil Incorporated and Mitsubishi Corporation* [2011] 330 ITR 578 (Delhi). It was submitted before the Commissioner of Income-tax (Appeals) that in this judgment, this court held that section 195 places an obligation on the payer to deduct tax at source at the rates in force from the payments made and if the payer has defaulted in deducting the tax, it was open to the Income-tax Department to take action against the payer under section 201 of the Act but no action can be taken for recovery of the interest under section 234B from the non-resident assessee. It was further held in this decision that the non-resident will, no doubt, be liable to pay the income-tax on the income assessed upon it, but it cannot be held liable for payment of any advance tax thereon if the tax deductible by the payer in India exceeds the amount of advance tax payable on the estimated income. It was further held that the position would be so even if the income-tax was not in fact deducted from the remittance because section 209(1)(d) of the Act permitted the non-resident assessee to take credit, while computing its advance tax liability, for the amount of income-tax that was 'deductible' from the remittance, though not actually deducted. It was furthermore held in the judgment that once it was found that the liability was that of the payer under section 201 of the Income-tax Act, which permitted recovery of the tax from the payer by treating him as an assessee in default and also recovery of interest under section 201(1A) for the default in not deducting the tax, there can be no liability fastened upon the non-resident assessee to pay interest under section 234B."

11.3 In view of the facts of the case, the hon'ble court held that the assessee was liable for interest under section 234B, observing as under (pages 291-294 of 2 ITR-OL) :

"The learned counsel for the assessee submitted in the course of his arguments that the assessee and the Indian telecom equipment dealers cannot contract out of the statute and, therefore, even if such an arrangement had been made between them, it cannot be given effect to and the liability of the Indian payer under section 195(1) has to be strictly enforced. In other words, it was his contention that the Indian payers ought not to have paid any heed, and should have

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acted strictly in accordance with section 195(1), even assuming, but not admitting that there was such a request from the assessee. Taking a practical view of the matter, it is difficult to see how the Indian payers could have resisted the request which, according to our inference, was made by the assessee to them not to deduct tax from the remittances. The Indian payers have to keep in mind the future business prospects and it was necessary for them to keep the assessee in good humour so that the business relationship remains profitable for them. They would have been in no position to resist the request. Moreover, since the sales were claimed to have been concluded outside India, again it would be a fair and reasonable inference to be drawn that the Indian dealers would have had an interface with the assessee in USA while concluding the sale contracts and on such an occasion it is normal for the parties to finalise all aspects touching on their relationship including the tax compliances. It should also be remembered that no reason whatsoever has been given by the assessee as to why it did not press its appeals before the Commissioner of Income-tax (Appeals) on the question of liability to tax on its Indian income.

In the light of the view taken by us on the facts of the present case, we do not consider it necessary to discuss the plethora of authorities cited by both the sides. It is, however, necessary to just highlight one aspect of the matter. This was in fact pointed out on behalf of the Revenue also. It is open to the assessee to deny its liability to tax in India on whatever grounds it thinks fit and proper. Having denied its tax liability, it seems unfair on the part of the assessee to expect the Indian payers to deduct tax from the remittances. It is also open to the assessee to change its stand at the first appellate stage and submit to the assessment of the income. When it does so, all consequences under the Act follow, including its liability to pay interest under section 234B since it would not have paid any advance tax. Such liabilities would arise right from the time when the income was earned. Advance tax was introduced as a PAYE Scheme 'pay as you earn'. It is not open to the assessee, after accepting the assessment at the first appellate stage to claim that the Indian payers ought to have deducted the tax irrespective of the fact that the assessee itself claimed the Indian income to be not taxable. We can understand an assessee who admits its tax liability right from the beginning to contend that it was the responsibility of the payers to deduct the tax and if they did not, even then the tax which ought to have been deducted by them should be set off against the assessee's advance tax liabilities.

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That is the type of case dealt with in the decision of this court in *Jacabs* (supra). We were not referred to a single case where on facts similar to the case of the assessee before us, the court took the view that no interest under section 234B was chargeable. The case of *Mitsubishi Corporation* decided along with the case of *Jacabs*, was on facts similar to the assessee's case. However, as pointed out by us earlier, this court in *Jacabs* case proceeded on the assumption that the facts in *Mitsubishi Corporation* were similar to those in *Jacabs*. That assumption, as we have earlier demonstrated, with respect, is not borne out by the facts.

It further seems to us inequitable that the assessee, who accepted the tax liability after initially denying it, should be permitted to shift the responsibility to the Indian payers for not deducting the tax at source from the remittances, after leading them to believe that no tax was deductible. The assessee must take responsibility for its volte face. Once liability to tax is accepted, all consequences follow ; they cannot be avoided. After having accepted the liability to tax at the first appellate stage, it is unfair on the part of the assessee to invoke section 201 and point fingers at the Indian payers. The argument advanced by the learned counsel for the assessee that the Indian payers failed to deduct tax at their own risk seems to us to be only an argument of convenience or despair. As we have pointed out earlier, it is difficult to imagine that the Indian telecom equipment dealers of the assessee would have failed to deduct tax at source except on being prompted by the assessee. It may be true that the general rule is that equity has no place in the interpretation of tax laws. But we are of the view that when the facts of a particular case justify it, it is open to the court to invoke the principles of equity even in the interpretation of tax laws. Tax laws and equity need not be sworn enemies at all times. The rule of strict interpretation may be relaxed where mischief can result because of the inconsistent or contradictory stands taken by the assessee or even the Revenue. Moreover, interest is, inter alia, compensation for the use of the money. The assessee has had the use of the money, which would otherwise have been paid as advance tax, until it accepted the assessments at the first appellate stage. Where the Revenue has been deprived of the use of the monies and thereby put to loss for no fault on its part and where the loss arose as a result of vacillating stands taken by the assessee, it is not expected of the assessee to shift the responsibility to the Indian payers. We are not to be understood as passing a value-judgment on the assessee's con-

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duct. We are only saying that the assessee should take responsibility for its actions.

It is not unusual for the courts to invoke equitable considerations even while interpreting tax laws. In *R. B. Jodha Mal Kuthiala* v. *CIT* [1971] 82 ITR 570 (SC), Hegde J. opined thus (page 575) : 'It is true that equitable considerations are irrelevant in interpreting tax laws. But, those laws, like all other laws, have to be interpreted reasonably and in consonance with justice'. In *CIT* v. *J. H. Gotla* [1985] 156 ITR 323 (SC), it was held by the Supreme Court that though equity and taxation are often strangers, attempts should be made (to ensure) that they do not always remain so and if a construction results in equity rather than injustice, that should be preferred to the literal or strict construction. In *Calcutta Jute Manufacturing Co.* v. *CTO* [1997] 106 STC 433 (SC) ; [1997] AIR 1997 SC 2920 the Supreme Court held that if there is a provision in a taxing statute to compensate the state by charging interest, that provision need not be strictly construed but may be so construed as to effectuate its purpose. The court held (page 439 of 106 STC) :

'10. The State is empowered by the Legislature to raise revenue through the mode prescribed in the Act so the State should not be the sufferer on account of the delay caused by the taxpayer in payment of the tax due. The provision for charging interest would have been introduced in order to compensate the State (or the Revenue) for the loss occasioned due to delay in paying the tax (vide *CIT* v. *M. Chandra Sekhar* [1985] 151 ITR 433 (SC) ; [1985] AIR 1985 SC 114 ; and *Central Province Manganese Ore Co. Ltd.* v. *CIT* [1986] 160 ITR 961 (SC) ; [1986] 3 SCC 461 ; AIR 1987 SC 438. When interpreting such a provision in a taxing statute a construction which would preserve the purpose of the provision must be adopted. It is well-settled that in interpreting a taxing statute normally, there is no scope for consideration of principles of equity. It was so said by Rowlatt J. in *Cape Brandy Syndicate* v. *IRC* [1921] 1 KB 64 at page 71 :

"In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

The above observation has been quoted with approval by a Bench of three judges of this court in *CIT* v. *Ajax Products Ltd.* [1965] 55 ITR 741 (SC) ; AIR 1965 SC 1358). In another decision rendered by a

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Bench of three judges of this court in *State of Tamil Nadu* v. *M. K. Kandaswami* [1975] AIR 1975 SC 1871. It has been observed thus :

"In interpreting such a provision, a construction which would defeat its purpose and, in effect, obliterate it from the statute book should be eschewed. If more than one construction is possible, that which preserves its workability and efficacy is to be preferred to the one which would render it otiose or sterile."

We are, therefore, not adopting a construction which would upset or even impair the purpose in introducing section 10A in the Act. The return to be filed by the dealer is the full and correct return as referred to in section 10 and on failure to furnish such a return the liability to pay interest from the prescribed date would arise when assessment is completed.'

We think that the present case is one where such considerations should prevail in the interpretation of section 234B ; otherwise, it will not merely result in injustice but the purpose of the provision would not have been achieved. In any case, the facts of the present case are different, as we have earlier pointed out, from the facts obtaining in *Jacabs* (supra) and therefore, the said decision cannot be applied."

11.4 In the instant case also, the assessee has accepted the existence of the permanent establishment before the Assessing Officer and in that circumstances, it cannot take benefit that it was the responsibility of the deductor to deduct tax at source. In view of facts of the case being identical to the facts of the above case, we do not find any error in the order of the Assessing Officer on the issue in dispute. Accordingly, ground No. 4 of the appeal of the assessee is dismissed.

12 Ground No. 5 relating to initiation of penalty being premature at this stage is dismissed as infructuous.

13 In the result, the appeal of the assessee is dismissed.

14 Order is pronounced in the open court on February 21, 2020.

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[2020] 80 ITR (Trib) 699 (Delhi)

[BEFORE THE INCOME-TAX APPELLATE TRIBUNAL —
DELHI "SMC" BENCH]

BELMARKS METAL WORKS

v.

INCOME-TAX OFFICER

AMIT SHUKLA ***(Judicial Member)***

March 5, 2020.

SS ▸ ITA 1961, ss 147, 148
AY ▸ 2011-12
HF ▸ Department

REASSESSMENT—VALIDITY—CATEGORICAL INFORMATION CONTAINING ASSESSEE'S NAME WITH DETAILS OF SELLERS LATER FOUND TO BE HAWALA OPERATORS PROVIDING ACCOMMODATION BOGUS BILLS—ASSESSING OFFICER AFTER RECEIVING INFORMATION INDEPENDENTLY APPLYING HIS MIND AND RECORDING REASONS WHY PURCHASES NOT GENUINE—REASSESSMENT VALID—INCOME-TAX ACT, 1961, SS. 147, 148.

BUSINESS EXPENDITURE—BOGUS PURCHASES—SOURCE OF PURCHASE NOT OUTSIDE BOOKS OF ACCOUNT AND CORRESPONDING SALES NOT DISPUTED—NO REJECTION OF BOOKS OF ACCOUNT—SUPPRESSION OF GROSS PROFIT ON PURCHASES—PROFIT ELEMENT OF SUCH AMOUNT SHOULD BE ADDED AS INCOME—INCOME-TAX ACT, 1961, S. 37.

The assessee's case was reopened under section 148 of the Income-tax Act, 1961 on the basis of the information received from the Investigation Wing wherein it was mentioned that the Maharashtra Value Added Tax Department had forwarded the details of non-genuine/bogus bills availed of by the assessee during the year 2011-12. The Investigation Wing had forwarded the copies of statements of the bogus billers (hawala dealers) along with their tax identification numbers and the permanent account number details of beneficiaries, wherein the assessee was also found to be one of the beneficiaries mentioned in the information. In the information, it was mentioned that the assessee took bogus bills of Rs. 1,93,066 from S. In response to the notice the assessee had filed the return and submitted that the original return filed be treated as return filed in response to the notice under section 148. The Assessing Officer treated the information received from the Investigation Wing as correct and after incorporating the invoices and the details received from the Maharashtra Value Added Tax Department that K was not registered with the Maharashtra Value Added Tax Department, held that the purchase of Rs. 1,93,066 was bogus and added the amount to the income of the assessee.

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The Commissioner (Appeals) simply confirmed the assessment without adjudicating either on legal issue or on the merits. On appeal :

Held, *(i) that nowhere had the Assessing Officer disputed that the source of purchase as outside the books of account. In fact the purchase of the same amount and invoice had been recorded in the books of account and duly disclosed and the amount had been paid through banking channels. The corresponding sales had also not been disputed including the direct expenses and the gross profit. At the most, this could be a case where the assessee had made purchases in cash and taken an accommodation bills for the sum for which cheque amount had been issued. In such a case also, the source of purchase were from the books. Therefore, the entire purchases could not be treated as income of the assessee especially when the books of account had not been rejected and the sales and the gross profit stood accepted in the trading account. It could be at best, a case of suppression of the gross profit on the purchase of Rs. 1,93,066. Under these facts and circumstances, the profit element of such amount should be added as income. Accordingly, the Assessing Officer was directed to apply the gross profit declared by the assessee on purchase of Rs. 1,93,066 and deleted the balance.*

(ii) That in so far as the validity of the reopening under section 148, there was no merit in the contention of the assessee for the reason that, firstly, there was categorical information wherein the assessee's name appeared along with the details of the parties from whom the assessee had made purchases which were found to be hawala operators providing accommodation bogus bills. The Assessing Officer after receiving the information had independently applied his mind and recorded his reasons to believe why such a purchase was not genuine. Thus, there was no infirmity in the jurisdiction accorded under section 147.

Cases referred to :

CIT *v.* Bholanath Poly Fab Pvt. Ltd. [2013] 355 ITR 290 (Guj) (para 6)

CIT *v.* Godavaridevi Saraf (Smt.) [1978] 113 ITR 589 (Bom) (para 3)

CIT *v.* Kelvinator of India Ltd. [2010] 320 ITR 561 (SC) (para 3)

CIT (Pr.) *v.* Nandkishor Huaschand Jalan [2019] 412 ITR 357 (Guj) (para 6)

CIT (Asst.) *v.* Shiv Shakti Flour Mills (P.) Ltd. [2014] 162 TTJ (Gau) (TM) 568 (para 3)

CIT (Pr.) *v.* SNG Developers Ltd. [2018] 404 ITR 312 (Delhi) (para 6)

Nanubhai D. Desai *v.* Asst. CIT [2014] 162 TTJ (Ahd.)(SB) 673 (para 3)

Phool Chand Bajrang Lal *v.* ITO [1993] 203 ITR 456 (SC) (para 3)

I. T. A. No. 5198/Delhi/2018 (assessment year 2011-12).

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S. K. Sarkar, Chartered Accountant, for the assessee.

Saras Kumar, Senior Departmental representative, for the Department.

ORDER

Amit Shukla ***(Judicial Member)***.—The aforesaid appeal has been filed by the assessee against the impugned order dated June 7, 2018, passed by the learned Commissioner of Income-tax (Appeals)-XXXI, Delhi for the quantum of assessment passed under section 147/143(3) for the assessment year 2011-12. In various grounds of appeal, the assessee has challenged the validity of reopening under section 148 and on various grounds ; the addition of Rs. 1,93,066 on account of bogus purchases and levy of interest under sections 234B and 234C. 1

The facts in brief are that the assessee's case was reopened under section 148 on the basis of the information received from the Investigation Wing, New Delhi, wherein it was mentioned that the Maharashtra VAT Department has forwarded the details of non-genuine/bogus bill availed of by the assessee during the year. The Investigation Wing had forwarded the copies of the statements of the concerned bogus billers (hawala dealers) along with their TIN and permanent account number details of the beneficiaries, wherein the assessee was also found to be one of the beneficiaries mentioned in the information. In the information, it was mentioned that the assessee has taken bogus bill of Rs. 1,93,066 from M/s. Supreme Enterprises. Based on this information, the assessee's case was reopened under section 147 and accordingly, notice under section 148 was issued on February 28, 2014. In response to which the assessee has filed the return of income and submitted that the original return was filed on September 29, 2011 be treated as return filed in response to the notice under section 148. The Assessing Officer confronted the said information received from the Director of Income-tax (Investigation) to the assessee which was as under : 2

Beneficiary Tin	*Beneficiary name*	*Beneficiary PAN*	*Name PAN beneficiary*	*Address PAN beneficiary*	*Hawala Tin*	*Hawala name*
27160298426V	Belmarks Metal Works	AAFFB6650C	Belmarks Metal Works	Belmarks Metal Works, A237, Neb Valley, Sainik Farm, New Delhi	27500257887V	Supreme Enterprises

In response, the assessee vide letter dated November 13, 2014 submitted that the assessee-firm has no transaction with M/s. Supreme Enterprises. 3

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Further, the assessee has enclosed a tax invoice dated July 19, 2010 issued by M/s. Krupa Trading Company for the sale of CRCA Coil for Rs. 1,93,066. It was stated that M/s. Krupa Trading Company, was a dealer in iron, steel and hardware, having office at C/28/304, Mangal Shanti Nagar, CHS Limited, 3rd Floor, Shanti Nagar, Sect-3, Meera Road, East Mumbai, and was duly acknowledged by M/s. Belmarks Metal Works. On a perusal of the bill of M/s. Krupa Trading Company dated July 19, 2010 issued in favour of M/s. Belmarks Metal Works B-273, MIDC Malegaon, Sinner, Nasik, Mumbai, it was stated that TIN number is 27500257887V dated January 20, 2009. However, the Assessing Officer observed that as per the information provided by the Director General of Income-tax (Investigation), Mumbai, M/s. Supreme Enterprises was also having the same TIN 27500257887V. Again, the Assessing Officer asked the assessee as to why the purchase of Rs. 1,93,066 made from M/s. Supreme Enterprises be not treated as bogus. The assessee submitted and stated as under :

> "Please refer to annexure III, the assessee-firm has no transaction with M/s. Supreme Enterprises it appears that the reopening is purely based on the information of the Investigation Wing. Such a reopening is bad in law as per the above cited Tribunal order. We humbly submit that an order of a superior authority (in this case, Tribunal) is to be followed in letter and spirit unless it is reversed by another of the jurisdictional or even non-jurisdictional High Court and/or apex court. Please see *CIT* v. *Smt. Godavaridevi Saraf* [1978] 113 ITR 589 (Bom) ; *Asst. C1T* v. *Shiv Shakti Flour Mills (P.) Ltd.* [2014] 162 TTJ (Gauhati) (TM) 568 ; *Nanubhai D. Desai* v. *Asst. CIT* [2014] 162 TTJ (Ahd.)(SB) 673. Not only has a wrong name been quoted, even the figure of alleged bogus expenditure has shifted from Rs. 193,006 to Rs. 1,96,006. The hon'ble Supreme Court categorically stated in *Phool Chand Bajrang Lal* v. *ITO* [1993] 203 ITR 456 (SC) that an Income-tax Officer acquired jurisdiction which comes into his possession subsequently. The apex court further clarified in *CIT* v. *Kelvinator of India Ltd.* [2010] 320 ITR 561 (SC) that after April 1, 1989, there must be tangible material to come to the conclusion that there was escapement of income from assessment. Reason must have a link with the formation of the belief."

4 The learned Assessing Officer, however, treated the information received from the Investigation Wing to be correct and after incorporating the invoices and the details received from the Maharashtra VAT Department that M/s. Krupa Trading Company was not registered with the Maharashtra VAT Department, held that the purchase of Rs. 1,93,066 is bogus and added the same to the income of the assessee.

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The learned Commissioner of Income-tax (Appeals) after incorporating the assessment order has simply confirmed the assessment without even adjudicating either on legal issue or on the merits. 5

Before us, the learned counsel for the assessee submitted that the assessee is a manufacturer of cycle parts and has maintained regular books of account which is subjected to audit. As per the information received, it was stated that the assessee has made purchases from M/s. Supreme Enterprises, whereas no such purchase was made from the said party. In fact, it was made from M/s. Krupa Trading Co. and the purchases of Rs. 1,93,066 has been duly disclosed in the books of account and corresponding sales and gross profit has been accepted, therefore, there was no occasion to treat the purchases of Rs.1,93,066 as bogus. In any case and without prejudice, he submitted that, at the best, only profit element on such purchase if at all treated to be bogus can be added. In support, he strongly relied upon the judgment of the hon'ble High Court in the case of *Pr. CIT* v. *Nandkishor Huaschand Jalan* [2019] 412 ITR 357 (Guj) and *CIT* v. *Bholanath Poly Fab Pvt. Ltd.* [2013] 355 ITR 290 (Guj) On the validity of reopening, he submitted that, the reopening was based on the information received by the Investigation Wing and the Assessing Officer has even failed to apply his mind on the information, because had he done so then he would have to come to the conclusion that the assessee has not made purchase from M/s. Supreme Enterprises for that amount. In support, he relied upon the judgment of the hon'ble Delhi High Court in the case of *Pr. CIT* v. *SNG Developers Ltd.* [2018] 404 ITR 312 (Delhi). 6

On the other hand, the learned Departmental representative has strongly relied upon the order of the Assessing Officer and the learned Commissioner of Income-tax (Appeals) and submitted that, here in this case the information sent by the Investigation Wing specifically contained the details of the assessee who was mentioned as a beneficiary of the bogus purchases made from M/s. Supreme Enterprises. Apart from that, it can be seen that the TIN number of M/s. Krupa Trading Co. and M/s. Supreme Enterprises are the same. Thus, the onus was heavily upon the assessee to rebut the said information by credible evidence. Accordingly, the order of the Assessing Officer should be confirmed. 7

After considering the aforesaid submissions and on a perusal of the material placed on record, I find that on the basis of the information received from the Investigation Wing which was based on the information forwarded by the Maharashtra VAT Department that the assessee has availed of hawala entry of bogus bill purchases of Rs. 1,93,066 in the financial year 2010-11. Based on this information, reopening has been done under section 148. However, before the authorities below the assessee's 8

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contention has been that, firstly, the assessee has not made any purchases from M/s. Supreme Enterprises albeit it has made purchases from M/s. Krupa Trading Co. for the same tax invoice dated July 19, 2010 for sale of CRCA coil for Rs. 1,93,066 ; secondly, the said purchases have been duly debited in the books of account. The adverse inference has been drawn by the Assessing Officer on the ground that both M/s. Supreme Enterprises and M/s. Krupa Trading Co. have the same TIN number and M/s. Krupa Trading Co. with the same TIN was not registered with the Maharashtra VAT Department and registration of M/s. Supreme Enterprises has already been cancelled by the Maharashtra VAT Department. Accordingly, he has treated the entire purchases as bogus. However, from the perusal of the record, it is seen that, nowhere the Assessing Officer has disputed that the source of purchase is outside the books of account. In fact the purchase of the same amount and invoice has been recorded in the books of account and duly disclosed and the amount has been paid through banking channels. The corresponding sales have also not been disputed including the directed expenses and the gross profit. At the most, this could be a case where the assessee has made purchases in cash and has taken an accommodation bill for the same quantity for which cheque amount has been issued. In such a case also, the source of purchase are from the books, therefore, the entire purchases cannot be treated as income of the assessee especially when the books of account have not been rejected and sales and the gross profit stands accepted in the trading account. It could be at best, a case of suppression of the gross profit on the purchase of Rs. 1,93,066. Under these facts and circumstances, I hold that the profit element of such amount should be added as income. Accordingly, the Assessing Officer is directed to apply the gross profit declared by the assessee on purchase of Rs. 1,93,066 and the balance amount should be deleted.

9 In so far as the validity of reopening under section 148 is concerned, I do not find any merits in the contention of the learned counsel for the reason that, firstly, there was a categorical information wherein the assessee's name was appearing along with the details of the parties from whom the assessee has made purchases which were found to be a hawala operator providing accommodation bogus bills. The Assessing Officer after receiving the information has independently applied his mind and recorded his reason to believe as to why such a purchase is not genuine. Thus, I do not find any infirmity in the jurisdiction accorded under section 147 and the same is dismissed.

10 In the result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 5th March, 2020.

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