

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "L", MUMBAI**

BEFORE SHRI AMIT SHUKLA (JUDICIAL MEMBER)

AND

SHRI ASHWANI TANEJA (ACCOUNTANT MEMBER)

I.T.A. No. 56/Mum/2011 - A.Y. 2006-07

I.T.A. No.8755/Mum/2011 - A.Y. 2008-09

Interwoven Inc. India Branch Regus Centre Point, 2 nd Floor 294 CSI Road, Near Mumbai University, Off Bandra Kurla Complex, Kalina, Santacruz (E), Mumbai-98	vs	The Dy. Director of Income-tax (International Taxation) 3(1), Mumbai
PAN : AABCI1525K		
(Appellant)		(Respondent)

I.T.A. No.435/Mum/2011

(Assessment Year 2006-07)

The Dy. Director of Income-tax (International Taxation) 3(1), Mumbai	vs	Interwoven Inc. India Branch Regus Centre Point, 2 nd Floor 294 CSI Road, Near Mumbai University, Off Bandra Kurla Complex, Kalina, Santacruz (E), Mumbai-98
PAN : AABCI1526K		
(Appellant)		(Respondent)
Appellant by		Shri Vishnu Bagri
Respondent by		Shri Jasbir Chouhan

Date of hearing : 07-11-2016

Date of pronouncement : 30-11-2016

ORDER

Per ASHWANI TANEJA, AM

These three appeals pertain to the same assessee, therefore, these were heard together and are disposed of by this common order.

2. First we shall take up appeal filed by the assessee in ITA No.56/Mum/2011 for A.Y. 2006-07 against the order of the Commissioner of Income-tax (Appeals)-10,Mumbai [hereinafter called the CIT(A)] passed against the assessment order u/s 143(3) dt 31-12-2008, on the following grounds:

"1. The order passed by the Hon'ble Commissioner of Income-tax (Appeals) ('Hon'ble CIT(A)') is contrary to law and facts of the Appellant's case.

2. The Hon'ble CIT(A) erred in law as well as in facts in holding that the Appellant's branch office in India ('India BO') constitutes a permanent establishment ('PE') in India in terms of Article 5 of the India-US Double Taxation Avoidance Agreement ('US DTAA').

3. The Hon'ble CIT(A) erred in law as well as in facts in holding that the fee for software maintenance of Rs. 52,92,089 / - received by the Appellant during the year constitutes fee for included services ('FIS') in terms of Article 12 of the US DTAA.

4. Without prejudice to Ground 2, the Hon'ble CIT(A) erred in not accepting the Appellant's submission that there is no necessity for further attribution of income to the India BO, since the India BO has been compensated at arm's length.

5. The Hon'ble CIT(A) erred in law by not adjudicating on the Appellant's plea that even the income of Rs. 1,14,00,547, though offered in the return of income as FIS, is not taxable since it is not FIS in terms of Article 12 of the US DTAA."

3. Ground 1 : This ground is general and does not need any adjudication.

4. Ground 2 : In this ground, the assessee has challenged the action of Ld. CIT(A) in holding that assessee's branch office in India constituted a Permanent Establishment (PE) in India in terms of Article 5 of India-US Double Taxation Avoidance Agreement (DTAA, in short).

5. The brief facts as noted by the AO in his assessment order are that the assessee is a company registered in USA. The assessee's business during the year was developing software and distributing the software products in India and also provided after sales services. The assessee also had its branch office in India, located in Mumbai. The assessee company provided software products to the end users in India under a licence agreement and the use of the software was subject to the agreement. The return of income was filed by the assessee offering the business income earned by the branch of the assessee to tax on account of management fee for providing marketing support services after deductible expenses. Net profit of the branch was offered to tax in the return of income filed. The assessee also offered professional income earned by it amounting to Rs.1,14,00,547. In the note appended to the return of income filed it was mentioned by the assessee that assessee (i.e. M/s Interwoven Inc. USA) had earned by way of sale proceeds Rs.3,82,56,224 (i.e. USD 9,60,657) from sale of (licence of software) products by the assessee directly to the customers in India. But the same was not offered to tax as it was sale of goods and payment of the same was of nature of business income and it was not taxable in India either under the Income-tax Act or under Article 7 of DTAA as the same was not connected to branch / any PE of the assessee in India. The assessee also relied upon various judgements in support of its claim.

6. But, during the course assessment proceedings, the AO did not accept the return of income filed by the assessee and recomputed the income by treating the branch office as PE of the assessee. It was held by the AO that gross revenue from sale of software directly in India

amounting to Rs.3,82,56,224 was liable to be taxed as business profits under the head 'Income from business' since the aforesaid branch office constituted PE of the assessee company. In addition to that, the income from FIS of the assessee as well as income from marketing activities of the branch were also held as taxable as part of business profits of the assessee company in India.

7. Being aggrieved, the assessee filed appeal before CIT(A) and made detailed submissions to challenge the assessment order on various fronts. The Ld. CIT(A) allowed part relief by accepting some of the grounds and rejecting the remaining. The Ld. CIT(A) upheld the action of the AO in treating the branch office as PE and also confirmed the action of AO in holding that if fee for software maintenance of Rs.52,92,089 received by the assessee during the year constituted fee for included services (FIS) in terms of Article 12 of DTAA and also confirmed the addition of Rs.1,14,00,547 which was offered by the assessee also in its return as FIS in terms of Article 12 of DTAA. Further, Ld. CIT(A) did not accept assessee's submission that there was no necessity for further attribution of income to the Indian branch office since the Indian branch office had already been compensated at arm's length price. However, Ld. CIT(A) accepted the claim of the assessee and held that sale of shrink wrap software did not involve receipt of consideration which could be said to be 'royalty'. As a result of order of Ld. CIT(A), both the parties filed appeal before the Tribunal to challenge the respective part of the order of Ld.CIT(A) against which they were aggrieved.

8. During the course of hearing before us, the foremost ground taken by the Ld. Counsel of the assessee was with regard to the action of the

lower authorities in treating the Indian branch office as PE of the assessee company in India in terms of Article 5 of India US DTAA.

9. We have gone through the orders passed by the lower authorities as well as submissions made by both the sides before us. Since the issue of determination of PE goes to the root of the matter and all the issues are dependent upon it, we find it appropriate to deal with this issue first. It is noted that perusal of the order of AO reveals that from pages 32 to 40, the AO discussed at length the provisions of Article 5, few judgments, extracts from commentary on international taxation and ample law for deciding the issue of PE, but whether on facts in the case before us the Indian branch office constituted a PE of the assessee company, has not been discussed at all and nothing could be made out from the perusal of the assessment order as to how the Indian branch office constituted PE of the assessee company. Perusal of order of Ld. CIT(A) reveals that he has substantially reproduced or reiterated academic observations of the AO and though he has given few observations briefly on factual aspects, but these observations lack precision. Relevant part of observations of Ld. CIT(A) are reproduced hereunder for ready reference:

".....The Interwoven Inc.(India) is required to maintain adequate and complete sales organization to market, promote assist in delivery of Interwoven's Products in the Territory. As per scope of services contained in clause B of Annexure A, Interwoven Inc.(India) is required to distribute software of the interwoven and maintain , professional and training services offered by interwoven in connection with that software. As per clause (2) of terms and conditions, the contractor will maintain as representative set of products principally for demonstration purposes, a stock of merchandise belonging to Interwoven or otherwise make any commitments whatsoever on behalf of interwoven, as agent or otherwise. Clause (c) of para 2 provides

that contractor will use its best efforts to support Interwoven's efforts to market and solicit orders for the Products within the territory. Contractor will conduct its activities under this Agreement in a lawful manner, in accordance with the highest standards of fair trade, fair competition and" business ethics. The Contractor will occupy and maintain facilities adequate to perform its obligations under this Agreement. Contractor will retain and have at its disposal at all times an adequate staff of trained and qualified personnel to perform its obligations under this Agreement. It is also seen that Contractor, on the basis of estimated Costs where necessary, will prepare support fee invoices. From time to time, adjustments and allowances will be made in order to reflect differences between estimated and actual amounts. In the light of these facts, it is seen that the Interwoven Inc (India)is maintaining a stock of on behalf of the appellant and is habitually exercising authority to carry out and enter into contract for and on behalf of the HO, of course subject to the approval of the HO. Therefore the services performed by the Interwoven India would fall under the provisions of article 5(4) of the DT AA. Accordingly: appellant would have PE within the meaning of Article 5 of the DTAA."

10. During the course of hearing before us, it was submitted by the Ld. Counsel that brief observations given on facts by the Ld. CIT(A) are either based upon misappreciation of facts or presumptions and in some cases, these are contradictory to the real facts and thus various submissions made by the assessee in detail before the Ld.CIT(A) have not been met by him before upholding the action of the AO. Ld. Counsel of the assessee explained before us the entire role and function of the Indian branch office. It was submitted that the Indian branch office was engaged in the provision of sales and marketing support services to Interwoven Inc., US, the Head Office (HQ), being:

- (a) Provision of an adequate and competent sales organization to market, promote and assist in the delivery of the HO's software products, maintenance and professional services;
- (b) Extending the HO's sales and campaigns in India; and
- (c) Support the solicitation efforts of the HO.

11. It was also submitted that as part of the services, the BO was to only support the solicitation efforts of the HO. The BO was not to have any authority to conclude contracts in the name of the HO. All orders received by the BO were forwarded to HO immediately upon receipt by the BO. All such orders were subject to acceptance or rejection by the HO for any reason whatsoever at HO's sole discretion. The BO was also not permitted to make any representations or warranties without prior written approval of the HO. The BO could also be required to maintain a stock only for demonstration purposes. The HO would directly ship products to customers, with support from the BO where required. It was reiterated that all contracts relating to software licenses and services were concluded by the HO directly with the customers and none of the sales were routed / concluded through / by the BO. The consideration for the software and services were received outside India and none of those receipts were reflected in the bank account of the BO.

12. Further, during the FY 2005-06 relevant to the A.Y. 2006-07, the BO had three employees. With a view to demonstrate the limited activity profile of the BO, appointment letters

issued to the employees of the BO were also filed by Ld Counsel before us. The BO derived cost-plus 10% remuneration for the marketing support services. The arm's length nature of the said remuneration was established through a transfer pricing benchmarking study undertaken by the BO.

13. The Ld. Counsel heavily relied upon the recent judgment of the Mumbai Bench of the Tribunal in the case of Variant India Pvt. Ltd vs ADIT (33 Taxman.com 249 dated 27-02-2013) wherein various yardsticks were proposed for deciding the issue as to under what circumstances a branch office would constitute a PE in India of a foreign enterprise. In the said decision, the facts were that VIPL was a company incorporated in the US and it had a branch office (called as VIPL-BO) in India. VIPL-BO was engaged as indenting agent of foreign products. Following features were noted by the bench in the said case:-

- i. VIPL BO is not a party to any legal contract with the customer;
- ii. VIPL BO does not take title or own or have risk of loss to the product, at any point of time;
- iii. VIPL BO does not invoice the customer;
- iv. VIPL BO does not receive funds from customers (the payments are being made by the Indian customers directly to Varian Group of Companies);
- v. VIPL BO does not remit funds to the Varian Group of Companies on behalf of the customers;
- vi. The title of goods passes directly from the Varian Group of Companies to the customer;
- vii. All other functions like unloading of shipment,

warehousing, opening a Letter of Credit (LC), bank guarantee, etc. are executed directly by the Importer /customer.

14. After analyzing the aforesaid features of the activities and functioning of branch office of VIPL it was held by the bench that the aforesaid activity profile shall not constitute the Indian branch office as dependent agent PE in India. It was also observed that the orders relating to Indian sale were only introduced and co-ordinated by the branch office and were not secured by it, and these orders were not binding on the principal companies, only these were accepted by them. The branch office had no authority to accept orders on behalf of any of the foreign group companies. During the course of hearing, it was strongly contended by the Ld. Counsel that the facts involved in the case before us are identical. With a view to draw parity between the facts of the said case and the facts of the case before us, the following factual analysis was made before us by the Ld. Counsel:-

15. It was submitted that the Indian branch office of the assessee company was engaged in marketing, promoting and assisting and delivery of products of the assessee company in India and extending its sales and marketing programmes and components in India. Following features in the activity profile of the assessee company and its branch office were brought to our notice:-

“i. BO is not a party to any legal contract with the customer; the Head Officer enters into such

contracts;

- ii. BO does not take title or own or have risk of loss as to the software products, at any point of time;
- iii. HO, and not BO, invoices the customer;
- iv. BO does not receive funds from customers (the payments are being made by the Indian customers directly to the bank account of Interwoven, US);
- v. BO does not remit funds to the HO on behalf of the customers;
- vi. The right to use the license in the software passes directly from the HO to the customers;
- vii. Credit terms in relation to the issue of the shrink wrap license are at the discretion of the HO and the BO is not involved in this function.
- viii. HO provides the software license directly to the customer.

16. In addition to the above, the Ld. Counsel of the assessee took us through few pages of the paper book to support his arguments and also relied upon various judgments for supporting his stand that Indian branch office did not constitute assessee's PE in India. It was also brought to our notice that the branch suspended its operations from 01-01-2007.

17. It was submitted that in view of the aforesaid facts, the well settled legal principles were not correctly applied. It was submitted that as per Article 5(1) of the US DTAA, where the activity test is not satisfied, irrespective of the nature of the establishment, a fixed place cannot constitute a PE. Article 5(1) defines a PE to mean a fixed place of business

through which the business of the enterprise is partly or wholly carried on. This postulates the requirement of the fixed place satisfying the 'activity test'. In this regard, reliance was placed on the ruling of the Bangalore ITAT in the case of Dy. DIT v. Jebon Corporation India Liaison Office (125 ITD 340) and upheld by the Karnataka High Court (HC) in Jebon Corporation India v. CIT (19 taxmann.com 119);

18. Further, our attention was drawn upon paragraph 2 to the Commentary on Article 5 of the OECD Model Tax Convention to argue that even where a fixed place of business satisfies the activity test, but if the activities of the BO are of a preparatory or auxiliary character, then it would not constitute PE. In this regard, reliance was placed on the judgment of Hon'ble Delhi High Court in U.A.E. Exchange Centre Ltd. v. Union of India (313 ITR 94). Similar principles were applied by the Supreme Court in the case of DIT v. Morgan Stanley (292 ITR 416), by the Authority for Advance Rulings in KT Corporation (181 Taxman 94) and by the Mumbai ITAT in Dy. DIT v. Staubli A.G. India Branch Office (40 SOT 14).

19. It was submitted that the assessee does not have a PE in India under the Agency PE of the assessee in India since mere provision of marketing services or making fee collection from customers and forwarding would not result in concluding contracts or securing orders nor assistance in sale of products in India without any authority to negotiate terms

of sales or conclude a contract on behalf of principal.

20. It was emphasized that the BO was engaged in pre-sales marketing support services, and these activities cannot be regarded as concluding contracts or securing orders for or on behalf of the HO. Reliance was placed on principles emerging from the judgments of M/s eBay International AG v. Asst. DIT (25 taxmann.com 500); Lubrizol Corporation USA v. Asst. DIT (33 taxmann.com 424); and DDIT v. Daimler Chrysler A.G. (133 TTJ 766).

21. It was further submitted that the Ld. CIT(A) wrongly inferred the activities as were mentioned in the agreement. He submitted before us a brief analysis showing contradictions / mistakes as were done in the conclusion by the Ld.CIT(A) as against the factual position, which are reproduced as under:-

Conclusion of the Hon.CIT(A) based on the inter-co agreement	Factual position
The BO is required to distribute software of the HO and maintain professional and training services offered by HO in connection with software.	As per the agreement, the BO is required to provide an adequate and competent sales organisation to promote and assist in delivery of HO products. The products are defined to mean software distributed by the HO and maintenance, professional and training services offered by the HO. The BO does not

	have any authority to conclude contracts. Kindly refer p.115 of the PB submission in this regard.
The BO will maintain as representative set of products principally for demonstration, a stock of merchandise belonging to HO or otherwise make any commitments on behalf of HO.	The BO would maintain a stock of goods only for demonstration purposes. It would not make any commitments on behalf of HO. Kindly refer p.115 of the PB submission in this regard.
The BO on the basis of estimated costs will prepare support fee invoices; from time to time adjustments would be made to these amounts to reflect differences between estimated and actual amounts.	The BO would not raise invoices on customers. The BO would raise invoices for its support fee on the HO. For this, a detailed methodology is to be adopted by it which would include making adjustments to reflect differences between estimated and actual amounts. Kindly refer p.118-119 of the PB submission in this regard.

22. Per contra, the Ld. CIT-DR strongly supported the order of CIT(A) as well as AO. But he was neither able to accept these analysis nor was he in a position to point out anything wrong in the factual analysis submitted by the Ld. Counsel. It was fairly accepted by him that lower authorities have not actually appreciated this aspect in detailed manner.

23. We have gone through the entire spectrum of the facts made available before us. It is noted by us that there are

apparent contradictions in the facts narrated by the Ld. Counsel before us and as has been noted by Ld. CIT(A) to arrive at the conclusions drawn by him. On the one hand, the Ld. CIT(A) is saying that while branch office will maintain stock, but the assessee states that the branch office was required to maintain stock of goods only for demonstration purposes and was not permitted to make any commitments on behalf of head office. Similarly, there are various other contradictions which have been tabulated in earlier part of our order. In addition to that various features as have been brought out before us, the activity profile of the branch office has not been examined by either of the lower authorities. As has been observed by us in earlier part of our order that the AO has not done any factual analysis at all and the Ld. CIT(A) has done a brief factual analysis but that was full of mistakes or lacks clarity and precision. Under these circumstances, it is difficult at this stage to apply the correct legal principles on the real facts. Therefore, we find it appropriate to send this issue back to the file of the AO who shall take into account all the facts and circumstances of the case and pleadings and documentary evidences as has been made before us and that may be made by the assessee before the AO in support of its claim. The AO shall give adequate opportunity of hearing to the assessee for furnishing all detailed submissions and requisite documentary evidences and these shall be taken into account before deciding this issue afresh. The AO shall accordingly

decide the issue keeping in view the facts of the case and applicable judgments as may be relied upon by the Ld. Counsel before the AO to decide whether the Indian branch constitutes a PE in India of the assessee company in terms of Article 5 of India-US DTAA. This ground may be treated as allowed for statistical purposes.

24. Grounds 3 to 5: These grounds are dependent upon the first ground, i.e. determination of PE. The assessee shall be at its liberty to furnish submissions and requisite evidences depending upon the outcome of the first ground and shall be decided accordingly by the AO. These grounds are also sent back to the file of the AO to be decided after giving adequate opportunity of hearing to the assessee. These grounds may be treated as allowed for statistical purposes.

25. In Revenue's appeal in ITA No.435/Mum/2011, the only ground taken by the Revenue is with regard to the action of the Ld.CIT(A) in holding that sale of shrink wrap software did not involve receipt of consideration which could be said to be 'royalty'. The Revenue has contended that Ld. CIT(A) has erred in taking this decision as the Indian branch office acted as PE in India of the assessee company. Thus, this ground is dependent upon the outcome of the issue of determination of PE. The issue of PE has been restored to the file of AO for deciding it afresh. Since the issue in Revenue's appeal is dependent upon the issue of PE which has been restored to the file of AO, this ground is also restored to the file of the

AO. The AO shall first decide the issue of PE which has a bearing on the ground raised by the Revenue in its appeal and then decide the issues under appeal. The AO shall also take into consideration various judgments as may be relied upon by the assessee.

26. Now we shall take assessee's appeal in ITA No.8755/Mum/2011 for A.Y. 2008-09. It is noted that all the grounds raised in this appeal are identical to the grounds raised in A.Y. 2006-07. Since the grounds for A.Y. 2006-07 have been sent back to the file of the AO, we find it appropriate to send the grounds raised in this appeal also to the file of the AO with similar directions. All the grounds raised in this appeal shall be decided by the AO after providing adequate opportunity of hearing to the assessee. The grounds raised in this appeal, are therefore, treated as allowed, for statistical purposes.

Order pronounced in the court on this _30th day of November, 2016.

Sd/-	Sd/-
(AMIT SHUKLA)	(ASHWANI TANEJA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt: 30th November, 2016

Pk/-

Copy to:

1. The appellant
 2. The respondent
 3. The CIT(A)
 4. The CIT
 5. The Ld. Departmental Representative for the Revenue, G-Bench
- (True copy) By order

ASSTT.REGISTRAR, ITAT, MUMBAI BENCHES