

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

**BEFORE SHRI G.S. PANNU, ACCOUNTANT MEMBER AND  
SHRI RAM LAL NEGI, JUDICIAL MEMBER**

<b>ITA NO. 134/MUM/2009</b>	<b>:</b>	<b>(A.Y : 2005-06)</b>
<b>ITA NO. 8598/MUM/2011</b>		<b>(A.Y : 2006-07)</b>
<b>ITA NO. 113/MUM/2006</b>		<b>(A.Y : 1996-97)</b>
<b>ITA NO. 1798/MUM/2007</b>		<b>(A.Y : 1996-97)</b>
<b>ITA NO. 114/MUM/2006</b>		<b>(A.Y : 1997-98)</b>
<b>ITA NO. 1799/MUM/2007</b>		<b>(A.Y : 1997-98)</b>

Nagase and Company Ltd.  
C/o. S.R. Batliboi & Co.,  
18<sup>th</sup> floor, Express Towers,  
Nariman Point, Mumbai 400 021.  
**PAN : AABCN2879G** (Appellant)

Vs. DDIT (IT), Range-4(1)/  
DDIT (IT)-4(2)/  
ADIT (IT), Range-3(1)/  
ADIT (IT), Range-3(2)/  
ADIT (IT), Range-3(1)/  
ADIT (IT), Range-3(2)  
Mumbai (Respondent)

<b>ITA NO. 412/MUM/2009</b>	<b>:</b>	<b>(A.Y : 2005-06)</b>
<b>ITA NO. 8205/MUM/2011</b>		<b>(A.Y : 2006-07)</b>
<b>ITA NO. 340/MUM/2006</b>		<b>(A.Y : 1996-97)</b>
<b>ITA NO. 367/MUM/2006</b>		<b>(A.Y : 1997-98)</b>

ADIT(IT)-4(2)/  
DDIT(IT)-4(2)/  
ADIT(IT)-3(2)/  
ADIT(IT)-3(2)  
Mumbai (Appellant)

Vs. Nagase and Company Ltd.  
C/o. S.R. Batliboi & Co.,  
18<sup>th</sup> floor, Express Towers,  
Nariman Point, Mumbai 400 021.  
**PAN : AABCN2879G** (Respondent)

**Assessee by : Shri Nitesh Joshi**  
**Revenue by : Shri M.V. Rajguru**

**Date of Hearing : 02/04/2018**

**Date of Pronouncement : 27/04/2018**

**ORDER****PER BENCH :**

The captioned are ten appeals pertaining to the same assessee for Assessment Years 1996-97, 1997-98, 2005-06 and 2006-07 and since they involve certain common issues, they have been clubbed and heard together and a consolidated order is being passed for the sake of convenience and brevity.

2. Before we proceed to take-up the respective appeals, a brief background of the proceedings can be summarised as follows. The assessee before us, M/s. Nagase and Co. Ltd., is a company incorporated in Japan, which is engaged in the business of chemicals, dyestuffs, plastics, electronic materials, cosmetics, etc. It makes sales to Indian customers directly as well as through independent agents appointed in India. The said concern has a Liaison Office (LO) in Mumbai which has been set-up in terms of specific prior approval of the Reserve Bank of India (RBI). In terms of the permission of RBI, LO's activities are confined to liaison and representative activities and it is not permitted to carry out any business/commercial activities in India. It transpires that on 06.02.3003, a survey action u/s 133A of the Income Tax Act, 1961 (in short 'the Act') was carried out at the office premises of the LO and certain books of account/documents were impounded. As a consequence of the findings of the survey action, Revenue took a stand that the activities of the LO involved identifying, negotiating and concluding business contracts in India for and on behalf of its parent office and, therefore, the LO was to be considered as a Permanent Establishment (PE)

of the assessee in India. On the contrary, the stand of the assessee was that the LO was involved in only liaison and representative activities and was not involved in any trading or commercial activity so as to be construed as a PE of the assessee in India. Notably, the Head office had appointed Commission agents in India who were independent entities and the H.O was also making sales to Indian customers directly. Notably, consequent to the survey, Revenue issued notices u/s 148 of the Act on 25.03.2003 covering Assessment Years 1996-97 to 2002-03 and the returns were filed by the assessee in response thereof, declaring NIL income, being a tax-resident of Japan.

3. In the assessments finalised for Assessment Years 1996-97 to 2002-03, which are more or less on similar basis, the Assessing Officer held that the LO was to be understood as a PE in India in terms of the India-Japan Double Taxation Avoidance Agreement (DTAA); and in determining the total taxable income, the Assessing Officer invoked Rule 10 of the Income Tax Rules, 1962 and estimated the profit at 10% of the total turnover from India. In this background, the learned representative for the assessee pointed out that the assessment pertaining to Assessment Year 1998-99 came up before the Tribunal and vide its order in ITA Nos. 1800/Mum/2007 & 115/Mum/2006 dated 12.01.2017, the stand of the assessee that the LO could not be construed as a PE was upheld. In this context, our attention has been drawn to the operative portion of the order of the Tribunal dated 12.01.2017 (supra), which we reproduce hereinafter :-

*“5.1. It is said that for income tax proceedings, each AY. is a separate assessment unit and liability to pay tax depends upon the fact as to whether any income had arisen or accrued to an assessee in that particular*

*year or not. Events of earlier or subsequent years can be useful in that regard, but same should lead to establish the basic fact in a particular year the assessee had received certain income or income had accrued to it. In the case under consideration, the AO/FAA referred to certain impounded documents to establish that the LO was, in fact, functioning as PE of the assessee for the year under appeal and hence its income should be taxed in India. Therefore, we are of the opinion that issue of existence of PE should be decided first.*

*For that purpose it would be essential to refer to the impounded material. One of the document relied upon by the AO is PRR of one of the employees. We find that it talks of the performance of one of the employees for the FY.1998-99 i.e. for the AY.1999-2000. In our opinion, the report has no relevance for deciding anything for the year under consideration. Now, we would like to analyse the other documents that are relevant for the instant AY. Agreement dtd.13.09.1996, entered in to between LG Chemicals Ltd. Korea and Nagase & Co.(pg.517-22) take of granting non transferable rights to distribute certain chemicals. The agreement was valid up to December,1996.No other document was referred to by the AO/FAA to prove that the agreement was renewed was acted upon during the year under appeal. Pg. 523 of the PB is a letter from one of the employees of the assessee to its Shanghai office. In that letter the employee has advised the Shanghai office as to how to deal with Indian customers. But, it does not prove that the assessee was indulging in sales activities. A fax message from GS on 15.07.2000 to the HO(Pg.537-39) clearly show that till July,2000 LO was supposed to find out the 'business possibilities' in the various parts of India. It also talks that intention of the Bombay office was not to do 'independent business'. Letter from one of the employees to HO (Pg.546) pertains to some information about purchases to be made as per the 'comments/ order' of the HO. Pg.559 of the PB is a letter from Musk and Fragrance (M&F) to LO. We have not come across any evidence that can prove that LO had directly dealt with the agent. The assessee had claimed that information received from M&F had been forwarded to HO. The AO had not commented upon the assertion made by the assessee. The next document (Pg.567) talks about meeting of members of the LO with agent and one of the manufacturer. It does not prove that the LO was carrying out business activities.*

5.2. *There is a very thin line between liasoning/providing auxiliary services and doing business. In the first instance support is given by LO to its HO who looks after the business. But, if the LO starts taking independent business decisions, including dealing with the customers, same could not be treated preparatory/auxiliary services. Providing/collecting information and acting as per the instructions of the HO will not definitely fall in the category of doing business independently. So, until and unless some reliable evidence is not brought on record it cannot be held that an assessee was not liasoning or was doing business. What has to be seen is that with whom the decision making power lies. If the LO has to follow the directions/command of the HO then the reins of the business would not be in its hands and it cannot be treated an independent entity. But, if it informs the HO, after entering in to business transaction on its own, about the results of its business activities then the HO cannot claim that the HO was assisting it. In the matter of UAE Exchange Centre (313 ITR 94), the Hon'ble Delhi High Court has held as under:*

*"The plain meaning of the word " auxiliary" is found in the Black' s Law Dictionary 7th Edition at page 130 which reads as " aiding or supporting, subsidiary" .....Once an activity is construed as being subsidiary or in aid or support of the main activity it would, according to us, fall within the exclusionary clause. To say that a particular activity was necessary for completion of the contract is, in a sense saying the obvious as every other activity which an enterprise undertakes in earning profits is with the ultimate view of giving effect to the obligations undertaken by an enterprise vis-a-vis its customer. If looked at from that point of view, then, no activity could be construed as preparatory or of an " auxiliary" character."*

*From the above discussion it is clear that any activity being subsidiary or in aid or support of main activity has to be treated auxiliary or preparatory activity. Perusal of the impounded documents, relevant for the year under appeal, have not led us to the conclusion that the LO was offering services that were not auxiliary.*

5.3. *We have not come across any statement of any of the employees or the officials / executives of the LO, recorded during the survey proceedings or after the action u/s. 133A of the Act was over. Generally, during the such operations statements are recorded and questions are asked about relevant and important impounded documents. There is no doubt that two of the employees GS and Vinod Balgi were employer of the LO for the year under consideration. But, that does not lead to any final conclusion. No question was ever asked to them about the duties assigned to them or about the responsibilities shared by them. Their appointment letters would have given some clues about their job profile. Nothing is on record that can prove that the LO was functioning as an independent profit center for the year under consideration. We want to make it clear that our observations are for the AY.1998-99 and they are in no way binding for any other AY. We have analysed the papers that are relevant for the year under consideration only and our decision is also based solely on those documents.*

5.4. *Here, we want to mention that we have taken note of a portion of order of the AO, wherein he has mentioned that he would inform the RBI about the violations made by the LO in conducting its activities. We are not aware as to what was the outcome of that exercise. The FAA or the DR has not mentioned anything about the correspondence entered into with the RBI. We are aware that decision of RBI may not be very relevant for determining the tax liability of an assessee. But, if the RBI has, after receiving a communication from the AO, not initiated any proceedings against the assessee for violating the terms and conditions of the permission letter issued to it by the Bank for operating the LO, then it will strengthen the case of the assessee. By not taking any action against the assessee, the RBI has accepted the plea that the LO was performing the activities that were allowed by the Bank. Considering the above, we are of the opinion that there is no evidence that the LO was functioning as PE of the assessee in India for the year under appeal. First effective ground is decided in favour of the assessee.*

*As all the other grounds, raised by the assessee, are alternative grounds, so, we allow them for statistical purpose.”*

4. Notably, while the Tribunal in Assessment Year 1998-99 upheld the point that the LO did not constitute a PE in India, it clarified that its said finding was based on the appreciation of the material and evidence which was sought to be brought out by the Assessing Officer based on the findings of the survey action as well as other verification exercise carried out in the course of assessment proceedings. Our co-ordinate Bench has specifically brought out in para 5.3 of the aforesaid decision that based on the documents and/or statements of the employees or officials recorded during the survey, there was nothing on record to suggest that the LO was functioning as an independent profit centre for the year that was under consideration before them. Thus, for Assessment Year 1998-99, the assessment made by the Assessing Officer was negated.

5. Further, the learned representative pointed out that a similar assessment made by the Assessing Officer for Assessment Year 2007-08 also came up before the Tribunal, and vide order in ITA No. 4654/Mum/2010 dated 30.11.2017, the primary stand of the Assessing Officer of the LO being a PE in India has been negated. In its order for Assessment Year 2007-08, again our co-ordinate Bench recorded a factual finding having regard to the material relatable to that year and concluded that there was no evidence to prove that the activities of the LO in India constituted any business connection of the assessee in India. In fact, after referring to the documents and materials relevant to the year before them, our co-ordinate Bench thereafter considered the question as to whether the activities of the assessee could constitute business connection in India in the context of Sec. 9 of the Act as well as Article 7 (or other similar Articles of India-Japan DTAA dealing with business income). Such findings of our co-ordinate Bench are

contained in para 5.2 to 5.4 of the order dated 30.11.2017, which are as under :-

*“5.2. Independently of the documents, whether the activities of the assessee would constitute business connection in India in the year under appeal is the second aspect the issue. In our opinion, section 9 of the Act and Article 7 of the DTAA.s(or other similar articles dealing with business income)would be helpful to solve the issue, as they deal with the concepts of PE and business connection.*

*5.2.1. Section 9 provides that income accruing directly or indirectly, through or from any business connection in India shall be deemed to be income accruing or arising in India. Hence, where the person entitled to such income is a non- resident, it would be included in his total income. However, Articles 7 of the DTAA.s (or other similar Articles) further stipulate that a PE must exists in India before income accrues and is taxable in India. Articles 5 of the DTAA.s (or similar Articles) define permanent establishment. Section 92F(iia) of the Act also defines permanent establishment. Once a PE exists and business is being carried out through it then profits, being a necessary consequence, needs to be attributed and taxed in India as per Rule 10 of the Income-tax Rules. The establishment of a PE presupposes that business operations are being carried out for profit.*

*5.2.2. For existence of a business connection one has to see that after a contract is entered into what are the terms of executing it. If the contract is performed fully or partly by the Indian subsidiary as an assignee or sub-contractee then it can be held that there is business connection. In other words, looking at the nature of the transactions and the manner in which contracts are executed and where the assessee assume and agree to third party claims and risks, a business connection is established. Real and intimate connection must exist between operations carried out in India and business by the non-resident.*

*The expression business connection was not defined for the purpose of section 9(1) (i), before 31/03/2003. By the Finance Act, 2003, two Explanations were inserted after the then existing Explanation which are*

*numbered as Explanations 1 and 2 to sub-section (1) of section 9 with effect from 1/04/2004. Explanation 2 contains an inclusive definition ; it brings the business activities specified in clauses (a) to (c) within the fold of the expression which has to be understood in its ordinary meaning.*

*A perusal of the provisions of section 9(1)(i), extracted above, shows that all income accruing or arising whether directly or indirectly through or from any business connection in India or from any property in India or through any assets or source of income in India or through transfer of capital assets situated in India, shall be deemed to accrue or arise in India. The mandate contained in clause(a) of the Explanation is that for the purpose of the afore -mentioned clause, where the business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. Explanation 2 contains an inclusive definition; it brings in the business activities specified in clauses (a) to (c), referred to above, within the fold of the expression business connection which has to be understood in its ordinary meaning. We would like to refer to the judgment of the Hon'ble Supreme Court in the case of R. D. Aggarwal and Co.(56 ITR 20). The expression business connection has been defined as under:*

*“The expression business connection postulates a real and intimate relation between the trading activity carried on outside the tax able territories and the trading activities within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity..... business connection contemplated by section 42 involves a relation between a business carried on by a non-resident which yields profits and 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 non-resident and the activity in the taxable territories, a stray or isolated transaction not being normally regarded as a business connection.”*

*5.2.3. In the light of above discussion, the essential features of business connection may be summed up as follows :*

- (a) a real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities within India ;*
- (b) such relation shall contribute, directly or indirectly, to the earning of income by the non-resident in his business ;*
- (c) 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 in India.*

*5.3. If the facts of the case for the year under appeal are tested on the touch stone of above principles and discussion it becomes clear that there was no business connection of the assessee in India. There is no evidence that can lead to the conclusions that the LO was executing the agreements independently with the customers. It was providing auxiliary or support services. The final decisions were taken by the parent company. The proverbial mind and management was located in Japan.*

*5.4. Now, we would like to discuss the cases relied upon by the DR. In the matter of Jabon Corporation India(supra)the Tribunal and the Hon'ble Karnataka High Court had taken note of the facts that the LO was empowered to conclude contracts and to secure purchase orders from the customers. In the case under consideration and for the year under appeal, there is nothing on record that the LO of the Non-resident entity was empowered to conclude any contract on its own. The matter of Brown and Sharp Inc. has been decided after considering the peculiar facts of that case. The AO or the FAA has not brought on record the fact that in the instant case any incentive plan was existing that could lead to the conclusion that the purpose of the LO in India was not merely to advertise the products of the assessee or to act as a link of communication between the assessee and a prospective buyer but involved activities which traversed the actual marketing of the products of the assessee in India. In the case of Brown and Sharp on the basis of the orders generated that an incentive was envisaged for the employees. In that matter the Hon'ble Court had arrived at the finding of the fact that the activity of the LO during that year was not of a preliminary or preparatory nature. Thus, the*

*judgment is year and activity specific. In our opinion, the cases relied upon by the DR are of no held to decide the issue against the assessee.*

*Considering the above, we hold that the LO was not functioning as PE of the assessee in India for the year under appeal. First effective ground is decided in its favour. As all other grounds, raised by the assessee, are alternative grounds, so, the same stand allowed for statistical purposes. We would like to emphasise that our decision is based on the facts for the year under appeal. It should not be taken as a precedent for any other year.”*

6. In the above background, we may now take-up for consideration the cross-appeals filed by the assessee and the Revenue for Assessment Year 2005-06, which is directed against the order of CIT(A)-33, Mumbai which in turn has arisen from the order passed by the Assessing Officer, Mumbai dated 27.12.2007 u/s 143(3) of the Act.

7. In this context, the respective Grounds of appeal read as under :-

ITA No. 134/Mum/2009 (Assessee's appeal)

“1. The learned CIT (A) has erred in confirming the action of the AO in holding that the Appellant's Liaison office constitutes its Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreement between India and Japan ('India-Japan tax treaty').

2. The learned CIT (A) has erred in confirming the action of the AO in holding that the sales made by the Appellant through independent agents in India are taxable in India.

3. The learned CIT (A) has erred in confirming the action of the AO in holding that there is no basic difference between the Appellant's dealings with the customers, directly or through independent agents.

4. *Without prejudice to grounds 1 to 3 above, the learned CIT (A) has erred in not accepting the principle that the profits attributable to the Permanent Establishment, if any, should be computed in accordance with Article 7(1) and 7(2) of the India-Japan tax treaty.*
5. *Without prejudice to grounds 1 to 3 above, the learned CIT(A) has erred in not adopting the average rate of commission paid by the Appellant to its independent agents, while determining the profits attributable to the Permanent Establishment.*
6. *Without prejudice to grounds 1 to 5 above, the learned CIT (A) has erred in regarding the entire gross profits of the Appellant from sales made in India as attributable and taxable in India. Further, the learned CIT (A) has disregarded the principle laid out in Explanation (1) (a) to Section 9 (1) (i) of the Act that only the profits attributable to operations carried out in India are taxable in India.*
7. *Without prejudice to grounds 1 to 5 above, erred in not directing the AO to reduce the salary paid to expatriates, during their period of stay in India while computing the profits attributable to the permanent establishment in India.*
8. *The learned CIT (A) has erred in upholding the levy of the interest under section 234B of the Act.*
9. *the learned CIT(A) has erred in upholding the initiation of penalty under section 271(1)(c) & 271B of the Act.”*

ITA No. 412/MUM/2009 (Revenue's appeal)

“1. *On the facts and in the circumstances of the case and in law, the Id. CIT(A) erred in estimating the profits at the rate of 3.73% as against 10% determined by the Assessing Officer by holding that the assessee has worked out India Specific Profits correctly whereas during the assessment proceedings assessee stated that it is not possible to ascertain the proper income pertaining to P.E.*

2. *On the facts and in the circumstances of the case and in law, the Ld. CIT (Appeals) erred in allowing a deduction of expenses amounting to Rs.1,07,97,060/-*

*by holding that the said expenses were met out for the purpose of business carried out by the P.E.in India.*

3. *The Appellant prays that the order of the Id. CIT(Appeals) on the above grounds be set aside and that of the Assessing Officer restored.”*

8. Notably, in the return of income filed for Assessment Year 2005-06, assessee declared NIL income and asserted that except for liaison office work, the LO had not undertaken any activity involving trading, commerce or industrial in nature, and that no commission or fee was charged nor any other remuneration was received by it for the liaison activity rendered. It was also canvassed that the entire expenses of the LO were met exclusively out of the remittances from the Head Office and that its activities were fully compliant with the terms and conditions of the permission granted by the RBI. It is noted that the Assessing Officer in para 3 of the impugned order concluded that the LO constituted a PE and further held that *“assessee has also failed to bring on record any evidence that it is not engaged in business activity (sales in India) in the instant year”*. It is also notable that the only basis taken by the Assessing Officer to treat the LO as a PE in India was the survey action as well as the assessment orders passed for the earlier assessment years. What we are trying to bring out is that in the impugned assessment year, the Assessing Officer has not given any independent reasoning for treating the LO as the PE of the assessee in India and has merely relied on the findings in the earlier assessment years. Similarly, the determination of total income has been made on the basis of estimation as per Rule 10 of the Rules whereby profit has been estimated at 10% of the sales construed to be made from India office and, in this manner, the total income was assessed at Rs.23,20,25,943/-.

9. When the matter was taken up before the CIT(A), the CIT(A) upheld the stand of the Assessing Officer that LO constituted the PE of the assessee in India under Article 5 of the DTAA between India and Japan. Against such a decision, assessee is in appeal before us on the abovestated Grounds of appeal. With regard to the quantification of income attributable to the PE in India, CIT(A) reduced the estimate made by the Assessing Officer inasmuch as he reduced the rate of profit from 10% to 3.73% and also allowed deduction for expenses amounting to Rs.1,07,96,060/- on the ground that the said expenditure was incurred for the purpose of business carried out by the PE in India. These aspects arising from the order of the CIT(A) have been challenged by the Revenue before us in the aforesated Grounds of appeal.

10. As a perusal of the cross-Grounds raised before us reveal, the first and the foremost issue to be decided is whether the assessee's LO in India constitutes a PE under Article 5 of the DTAA between India and Japan. Quite clearly, the dispute in Assessment Year 2005-06 is fully covered by the decision of the Tribunal in assessee's own case for Assessment Year 2007-08 dated 30.11.2017 (supra). Notably, the previous year relevant to the Assessment Year 2007-08 as well as the previous year relevant to the assessment year under consideration before us, i.e. 2005-06, are posterior to the date of survey, i.e. 06.02.2003 and, therefore, the material and evidence found in the survey would be of no relevance to decide the controversy in this year. In any case, as noted by us in the earlier paras, the Assessing Officer has not referred to any documents or evidence pertaining to the instant year in order to conclude that the assessee's LO constitutes its PE in India. The conclusion of the Assessing Officer is simply and purely

based on the stand of the assessing authorities for Assessment Years 1996-97 to 2002-03, which obviously relate to the period covered by the survey action u/s 133A of the Act. Even the decision of the CIT(A) is based on his decision for Assessment Years 2002-03 and 2003-04 and no independent reasoning has been given by him pertaining to the Assessment Year 2005-06.

11. In this background, we may refer to the relevant extract of the order of Tribunal dated 30.11.2017 (supra) for Assessment Year 2007-08, which has been reproduced by us in the earlier part of this order. Thus, following the parity of reasoning brought out by our co-ordinate Bench in its order dated 30.11.2017 (supra), we may note that so far as the instant year is concerned, there is no evidence and material referred to by the income-tax authorities so as to establish in the instant year that the LO was executing business or contracts independently with the customers in India and, therefore, the plea of the assessee that the LO was carrying only support activities and was engaged in preparatory and auxiliary activities deserves to be affirmed and the LO could not be construed as a PE in India. At this stage, we may also make an observation that the LO has been set-up in India as per the express approval granted by the RBI with the purpose of only carrying out liaison and representative activity for the Head Office and is not permitted to carry out any business/commercial activity in India. If the case sought to be made out by the Assessing Officer that the LO was engaged in any business activity is correct, it would definitely invite punitive action by the RBI but there is nothing on record to suggest any such action against the assessee. In fact, while adjudicating the dispute for Assessment Year 1998-99, the Tribunal in its order dated 12.01.2017 (supra) took note of a remark by the Assessing Officer in the assessment order that the information would

be sent to the RBI about the violations made by the LO in conducting its activities. Having noted the said observation contained in the assessment order, the Tribunal in para 5.4 of its order dated 12.01.2017 (supra) noted that there was no material to suggest that any action was taken by the RBI or whether any correspondence in this regard was at all made by the Assessing Officer or not. Be that as it may, even before us, there is nothing to suggest that the RBI has found the activities of the LO as being non-compliant with the terms and conditions of its permission and, therefore, the said factual matrix strengthens the assertions of the assessee that the LO was performing activities which were permissible by the RBI, meaning thereby, that it was only performing support activities and engaged in only preparatory and auxiliary activities and not in the nature of a PE so as to impute any business connection in India. Thus, following the precedent as also the aforesaid discussion, in our view, it is irresistible to conclude that the assessee's LO did not constitute a PE in India for the Assessment Year 2005-06. In this view of the matter, the Ground of appeal no. 1 raised by the assessee is allowed.

12. The other Grounds raised by the assessee are alternate pleas and so far as the Grounds raised by the Revenue in its cross-appeal are concerned, the same relate to computational disputes regarding the income attributable to the PE in India. Since we have upheld the principal plea of the assessee in Ground of appeal no. 1 that its LO does not constitute a PE, all other Grounds in the cross-appeal (except the Grounds in assessee's appeal which we discuss hereinafter) are rendered academic.

13. Before parting, we may also refer to a specific Ground raised by the assessee challenging the levy of interest u/s 234B of the Act. While completing the assessment, interest u/s 234B of the Act was levied by the Assessing Officer for default in payment of advance tax. It has been brought out that similar issue for Assessment Year 1998-99 was considered by our co-ordinate Bench in its order dated 12.01.2017 (supra) and decided in favour of the assessee following the ratio of the judgment of the Hon'ble Bombay High Court in the case of *NGC Network Asia LLC, 313 ITR 187 (Bom.)*. Following the aforesaid precedent, the plea of the assessee on this aspect is also upheld.

14. Thus, insofar as Assessment Year 2005-06 is concerned, the appeal of the assessee is allowed and that of the Revenue is dismissed.

15. Now, we may take-up the cross-appeals of the assessee and the Revenue pertaining to Assessment Year 2006-07 which are directed against the order of CIT(A)-11, Mumbai which in turn has arisen from the order passed by the Assessing Officer, Mumbai dated 20.12.2010 u/s 143(3) r.w.s 147 and 144C(3) of the Act. The respective Grounds of appeal raised by the assessee and the Revenue read as under :-

*ITA No. 8598/Mum/2011 (Assessee's appeal)*

*Reopening of assessment under section 148*

1. *The learned CIT(A) has erred in confirming the action of the AO in holding that the reopening of the assessment under section 148 of the Act is valid;*

2. *The learned CIT(A) has erred in not appreciating the fact that there was no material before the AO for escapement of Income and the notice was issued only with an intention to revive the time limit for issue of notice under section 143(2) of the Act;*

*Liaison Office considered to be a Permanent establishment in India*

3. *The learned CIT(A) has erred in confirming the action of the AO in holding that the Appellant's Liaison office constitutes its Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreement between India and Japan ('India-Japan tax treaty').*

4. *The learned CIT(A) has erred in confirming the action of the AO in holding that the sales made by the Appellant through Independent agents in India is taxable in India.*

5. *The learned CIT(A) has erred in confirming the action of the AO in holding that there is no basic difference between Appellant's dealings with the customers, directly or through independent agents.*

6. *Without prejudice to grounds 3 to 5 above, the learned CIT(A) has erred in not accepting the principle that the profits attributable to the Permanent Establishment, if any, should be computed in accordance with Article 7(1) and 7(2) of the India-Japan tax treaty.*

7. *Without prejudice to grounds 3 to 5 above, the learned CIT(A) has erred in not adopting the average rate of commission paid by the Appellant to its independent agents, while determining the profits attributable to the Permanent Establishment.*

8. *Without prejudice to grounds 3 to 7 above, the learned CIT(A) has erred in regarding the entire gross profits of the Appellant from sales made in India as attributable and taxable in India. Further, the learned CIT(A) has disregarded the principle laid out in Explanation (1) (a) to section 9(1)(i) of the Act that only the profits attributable to operations carried out in India are taxable in India.*

*Disallowance of transportation expenses*

9. *The learned CIT(A) has erred in upholding the action of the AO in disallowing 25% of transportation expenses amounting to Rs 301,353 under section 37(1) of the Act on the ground that the same have not been incurred for business purpose.*

*Disallowance of travelling expenses*

10. *The learned CIT(A) has erred in upholding the action of the AO in disallowing 25% of travelling expenses amounting to Rs 712,910 under section 37(1) of the Act on the ground that the same have not been incurred for business purpose.*

*Disallowance of conference expenses*

11. *The learned CIT(A) has erred in upholding the action of the AO in disallowing 25% of conference expenses amounting to Rs 100,243 under section 37(1) of the Act on the ground that the same have not been incurred for business purpose.*

*Levy of interest under section 234B of the Act amounting to Rs 46,07,602*

12. *The learned CIT(A) has erred in not deleting the levy of interest under section 234B of the Act.*

*ITA No. 8205/Mum/2011 (Revenue's appeal)*

“1. *On the facts and in the circumstances of the case and in law, the Id CIT(A) erred in deleting the disallowance of establishment expenditure incurred by Liaison Office (LO) u/s 37(1) of the I.T. Act by way of tax on behalf of an employee ignoring the fact that the tax was payable by the employee as an individual and hence the expenditure was personal in nature and related to business of assessee.*

2. *the appellant prays that the order of the Ld. CIT(A), Mumbai on the above grounds be set aside and the order of the Assessing Officer be restored.”*

16. *It was a common point between the parties that all issues raised in the cross-appeals, except Ground of appeal nos. 1 & 2 in the case of assessee's appeal, stand on identical footing to those considered by us in the earlier*

paras in relation to appeals for Assessment Year 2005-06. Therefore, our decision therein shall apply *mutatis mutandis* to the present cross-appeals also.

17. Insofar as Ground of appeal nos. 1 and 2 are concerned, the same relate to challenge to the validity of proceedings initiated by the Assessing Officer under Sections 147/148 of the Act for Assessment Year 2006-07. This aspect of the controversy is rendered academic inasmuch as on merits, assessee has fully succeeded in supporting its return of income filed at NIL and, therefore, such Grounds are not being adjudicated for the present and are being kept open.

18. Resultantly, whereas the appeal of the assessee for the Assessment Year 2006-07 is allowed, and that of the Revenue is dismissed.

19. Now, we may take-up for consideration the appeals pertaining to Assessment Year 1996-97. ITA Nos. 113 & 340/Mum/2006 are cross-appeals preferred by the assessee and the Revenue, which are directed against the order of CIT(A)-33, Mumbai dated 31.10.2005 which in turn has arisen from the order dated 29.03.2004 passed by the Assessing Officer u/s 143(3) r.w.s. 147 of the Act. Insofar as appeal in ITA No. 1798/Mum/2007 is concerned, the same is also related to Assessment Year 1996-97 which is preferred by the assessee against the order of CIT(A)-33, Mumbai dated 30.11.2006, which in turn has arisen from the order dated 27.02.2006 passed by the Assessing Officer u/s 143(3) r.w.s. 250 of the Act giving effect to the order of CIT(A) dated 31.10.2005.

20. Insofar as the circumstances prevailing before the Assessing Officer is concerned, the same is identical to Assessment Year 1998-99 which has already been considered and dealt with by the Tribunal in its order dated 12.01.2007 (supra). So, however, in order to recapitulate the following brief description is relevant. In the course of assessment proceedings, the Assessing Officer considered the LO to be a PE of the assessee in India and estimated the profit attributable to the PE in India by applying Rule 10 of the Rules considering 10% of the turnover relating to India, thus arriving at taxable income of Rs.4,41,43,800/-. The CIT(A) passed a consolidated order for Assessment Years 1996-97 to 2002-03 which, *inter-alia*, related to the year under consideration, i.e. Assessment Year 1996-97 also. The CIT(A) sustained the stand of the Assessing Officer that the LO constituted a PE of the assessee in India, against which assessee is in appeal before us in ITA No. 113/Mum/2006 on the abovestated Grounds of appeal. With regard to the quantification of income attributable to the PE in India, the CIT(A) had reduced the estimation made by the Assessing Officer, which is the subject matter of challenge by the Revenue before us on the basis of the aforesated Grounds of appeal.

21. In this background, we first take-up the cross-appeals by the assessee and the Revenue wherein also the first and foremost issue to be decided is whether assessee's LO in India constitutes a PE in India under Article 5 of the DTAA between India and Japan. The said dispute is manifested in Ground of appeal no. 1 in the appeal of the assessee. As we have noted earlier, the CIT(A) had passed a common order for Assessment Years 1996-97 to 2002-03, which covered the period of survey action u/s 133A of the Act, and had arrived at a finding common to all the assessment years. The said order of

CIT(A) was the subject matter of consideration by the Tribunal in Assessment Year 1998-99 vide order dated 12.01.2007 (supra). In the said decision, Tribunal upheld the plea of the assessee that the LO did not constitute a PE in India and, while doing so, noted that such a finding was based on documents and/or statements and other materials found during the survey which was relevant to the period before it. In the said light, in the instant year, the approach adopted by our co-ordinate bench has to be carried forward and the matter has to be examined in the said light. Thus, what is required to be examined for the present is as to whether there is any evidence or material found in the course of the survey or in the later assessment proceedings which would justify the assertion of the Revenue that the LO was functioning as an independent profit centre for the year under consideration, i.e., its services were not in the nature of mere support or auxiliary services. At the time of hearing, there was a common ground between the parties on the aforesaid approach. Therefore, in the said background, the learned representative pointed out a list of documents which have been referred to by the CIT(A) in his consolidated order for Assessment Years 1996-97 to 2002-03. On the basis of such tabulation, which has been perused in the course of hearing, it has been brought out that there is only one document pertaining to the previous year relevant to the assessment year under consideration, namely, a letter dated 28.09.1995 of one, M/s. Musk and Fragrance, which is addressed to the LO. Notably, in the assessment order no reference has been made to such a document, but the same has indeed been referred to by the CIT(A) who has also called for a Remand report also from the Assessing Officer. No doubt, in the Remand report submitted by the Assessing Officer, it has been canvassed by the Assessing Officer that the said document justifies the assertion that the LO

was directly dealing with the said agent. The Remand report of the Assessing Officer has been reproduced by CIT(A) in para 6.4 of his order and as per the Assessing Officer, the said communication from M/s. Musk and Fragrance to the LO proves the negotiations being carried out with the said agent regarding the requirement/order of goods instead of with the Head Office and, therefore, the activity of the LO could be construed as trading or commercial in nature. The CIT(A) has also considered the said document and in para 9.2 of his order has noted that the same, *inter-alia*, showed that the LO was directly dealing with the agents and thus the LO was directly involved in the business activity with the help of agents who were otherwise appointed by the Head Office.

22. Even before us, the stand of the Id. DR is that the said document shows that the agents appointed by the Head Office were not only dealing with the Head Office, but they were negotiating for business activity with the LO also.

23. On the contrary, the stand of the assessee is that M/s. Musk & Fragrance was an independent agent appointed by the Head Office and it had no direct dealing with the LO. The learned representative explained that the said agent has communicated with the LO merely to save the cost of communication with the Head Office in Japan; and, secondly, it is pointed out that the contents of this communication, a copy of which has been placed in the Paper Book at page 271, clearly brings out that the agent was in direct negotiation with the Head Office. So far as the requirement/order of goods contemplated in the said communication is concerned, LO had merely communicated it to the Head Office and that LO only acted as a

communication channel. The learned representative pointed out that the said communication was also taken note of by the Tribunal in Assessment Year 1998-99 and, for that matter, he has referred to the discussion contained in para 5.1 of the order of Tribunal dated 12.01.2017 (supra). The Tribunal has particularly noted the stand of the assessee that the communication of M/s. Musk & Fragrance was forwarded by the assessee to the Head Office and that the said assertion has not been negated by the Revenue. Therefore, it is sought to be canvassed that the said material cannot constitute an evidence to say that the LO was engaged in any business activity.

24. We have carefully considered the rival submissions. Factually speaking, *qua* the previous year relevant to the assessment year under consideration, the only evidence relied upon by the CIT(A) to hold that the LO was directly involved in the business activity by taking help of commission agents is the communication dated 28.09.1995 of M/s. Musk & Fragrance. Understandably, M/s. Musk & Fragrance is an independent Commission agent appointed by the Head Office and to that extent, there is no dispute. The claim of the Revenue is that the said communication shows direct business dealings between the LO and the said agent. In this background, we have perused the contents of the said communication, a copy of which has been placed in the Paper Book at page 271. The said communication is with regard to certain product 'Cital' which is explained to be used in the perfumery industry. The communication gives information about the current demand, customer-wise and the present prices of the product. It also refers to certain fax already sent regarding indent of a product. Much has been made before us of the words "*If we delay in*

*offering we hope we will loose the market which is developed after putting lot many efforts.”* appearing in the said communication to say that the LO was involved in business activity. In our considered opinion, the document does not indicate that the LO has carried out any business activity and, in fact, the assertion of the assessee has all along been that the said document has been merely forwarded to the Head Office on the request of the concerned agent.

25. At the time of hearing, the learned representative was asked to substantiate the fact that the LO acted only as a communication channel between the Head Office and the agent in question. The learned representative explained that the matter being very old, it would not be possible to dig-out the communication file, but it has been pointed out that for the relevant period covering the said communication dated 28.09.1995, there has been no sale of Citral in India. On this basis, it is sought to be canvassed that the said document is of no help in establishing that any business activity was directly carried out by the LO in India.

26. In our considered opinion, the manner in which our co-ordinate Bench in Assessment Year 1998-99 has considered the aforesaid material, in this year too, we do not find any reason to infer that the said communication from M/s. Musk & Fragrance dated 28.09.1995 demonstrates that the LO was involved in any business activity. Pertinently, in the context of similar communication of M/s. Musk & Fragrance for Assessment Year 1998-99, the Tribunal noted that the same cannot be construed that the LO was carrying out any business activity directly.

27. In our considered opinion, under such circumstances, what is of essence is to establish the place at which the decision making power to negotiate and conclude the contracts lie. As has been correctly noted by our co-ordinate Bench in the Assessment Year 1998-99, if the LO is to only follow the directions/command of the Head Office, then, its activities could not be treated as independent business activities. Factually speaking, in our view, *qua* the material available with the income-tax authorities relatable to the previous year relevant to the assessment year under consideration, it cannot be deduced that the LO was involved in negotiating and concluding any business contracts, leave alone doing so independent of the Head Office. Therefore, in our view, the situation in the instant assessment year is factually similar to that dealt with by our co-ordinate Bench in Assessment Year 1998-99 (*supra*). Consequently, in this year too, we arrive at the same finding as in Assessment Year 1998-99 (*supra*) that the activities of the LO in India would not constitute a PE in India. Thus, the substantive dispute, which is manifested by Ground of appeal no. 1 of the appeal of the assessee, is decided in favour of the assessee.

28. Insofar as the other Grounds raised by the assessee are concerned, the same are only alternate pleas and would not require any adjudication in view of our decision in Ground of appeal no. 1 in the above paras. So far as the Grounds raised by the Revenue in its cross-appeal are concerned, the same relate to computational disputes regarding the income attributable to the PE in India. Since we have upheld the principal plea of the assessee in Ground of appeal no. 1 that it's LO does not constitute a PE, all other Grounds are rendered academic.

29. Thus, insofar as the cross-appeals for Assessment Year 1996-97 is concerned, the appeal of the assessee being ITA No. 113/Mum/2006 is allowed and that of the Revenue is dismissed.

30. Insofar as the appeal of assessee being ITA No. 1798/Mum/2007 is concerned, the proceedings therein have become infructuous once we have allowed the substantive stand of the assessee manifested in Ground of appeal no. 1 in ITA No. 113/Mum/2006. As a consequence, the appeal of assessee in ITA No. 1798/Mum/2007 is allowed for statistical purpose.

31. Now, we may take-up for consideration the appeals pertaining to Assessment Year 1997-98 vide ITA Nos. 114 & 367/Mum/2006, which are cross-appeals preferred by the assessee and the Revenue directed against the order of CIT(A)-33, Mumbai, which in turn has arisen from the order dated 30.03.2004 passed by the Assessing Officer u/s 143(3) r.w.s. 147 of the Act. Insofar as appeal in ITA No. 1799/Mum/2007 is concerned, the same is also related to Assessment Year 1997-98 which is preferred by the assessee against the order of CIT(A)-33, Mumbai dated 30.11.2006, which in turn has arisen from the order dated 27.02.2006 passed by the Assessing Officer u/s 143(3) r.w.s. 250 of the Act giving effect to the order of CIT(A) dated 31.10.2005.

32. The appeals for Assessment Year 1997-98 are also taken-up in the same manner as has been done for Assessment Year 1996-97 in the earlier paras. In this year also, the Assessing Officer as well as the CIT(A) have referred to one piece of evidence to conclude that the LO was involved in business activities directly. The said piece of evidence is an agreement

dated 13.09.1996 between LG Chemicals Ltd., Korea and Nagase & Co. Ltd., Mumbai Liaison office. The copy of the said agreement is placed at pages 224-229 of the Paper Book and the purported agreement is for distribution and marketing of a product manufactured by LG Chemicals Ltd. in the territory of India.

33. On this aspect, the learned representative pointed out that before the Assessing Officer as well as the CIT(A), assessee had made detailed submissions by pointing out that the said material could not be relied upon to arrive at a conclusion that the LO was engaged in any business activity. Firstly, the stand of the assessee was that the said agreement was never acted upon inasmuch it was unsigned. The learned representative emphasised this point even before us, and also submitted that there is nothing brought out by the Revenue to say that any activity pursuant to the said agreement has indeed been carried out by the LO. It was also pointed out that even at the time of survey, no question was put to the assessee on this aspect. It has also been pointed out that the document being relied upon by the Assessing Officer is merely a fax copy and not the original.

34. On the other hand, the stand of the Revenue is that the document is an agreement whereby the LO is sought to be appointed as a distribution agent for a product manufactured by LG Chemicals Ltd., Korea and the same justifies the inference that the LO was tasked to carry out and execute business contracts also.

35. We have carefully considered the rival submissions. Factually speaking, a perusal of the agreement shows that there is no signature so far

as the assessee is concerned. We may also look at it from another angle. The purported agreement is dated 13.09.1996 and the Revenue has carried out the survey action u/s 133A of the Act on 06.02.2003, which is on a much later date. There is no material or evidence referred to in the orders of the authorities below which would show that any of the activities purported to be covered by the said agreement have indeed been carried out by the LO. Therefore, on a *prima facie* consideration of the material sought to be relied upon by the Assessing Officer, it cannot be made out that any business activity *qua* the said agreement was ever carried out by the LO. We find that the assessee had taken a categorical position before the Assessing Officer itself and stated that the agreement was unsigned and it eventually did not fructify. We do not find any material or clinching evidence led by the Assessing Officer to demolish the said stand of the assessee. On this aspect, the learned representative at the time of hearing had relied upon the judgment of the Hon'ble Delhi High Court in the case of *CIT vs Gian Gupta*, 369 ITR 428 (Del.) to point out that where the Memorandum of Understanding for purchase of land as well as receipts given by the seller found during the survey were unsigned documents, the same would not prove that the intended transaction had materialised. On the same analogy, in the instant case too, the agreement in question is unsigned by the assessee; and, secondly, the findings of the survey do not point to any of the activities stated in the said agreement to have been carried out by the LO of assessee in India. Therefore, in our view, the said evidence does not justify the inference that the LO was carrying out any business activity in India.

36. At this point, we may say that so far as the other documents relied by the CIT(A) in the common order dated 31.10.2005 are concerned, they relate

to assessment years other than the assessment year under consideration before us and, therefore, have not been considered by us. As noted earlier, the said approach is consistent with the approach adopted by our coordinate Bench while dealing with the dispute in Assessment Year 1998-99 vide order dated 12.01.2017 (supra). Therefore, following the said approach, we uphold the stand of the assessee that the LO could not be construed as a PE of the assessee.

37. Insofar as the other Grounds raised by the assessee are concerned, the same are only alternate pleas and would not require any adjudication in view of our decision in Ground of appeal no. 1 in the above paras. So far as the Grounds raised by the Revenue in its cross-appeal are concerned, the same relate to computational disputes regarding the income attributable to the PE in India. Since we have upheld the principal plea of the assessee in Ground of appeal no. 1 that it's LO does not constitute a PE, all other Grounds are rendered academic.

38. Thus, insofar as the cross-appeals for Assessment Year 1997-98 is concerned, the appeal of the assessee being ITA No. 114/Mum/2006 is allowed and that of the Revenue is dismissed.

39. Insofar as the appeal of assessee being ITA No. 1799/Mum/2007 is concerned, the proceedings therein have become infructuous once we have allowed the substantive stand of the assessee manifested in Ground of appeal no. 1 in ITA No. 114/Mum/2006. As a consequence, the appeal of assessee in ITA No. 1799/Mum/2007 is allowed for statistical purpose.

40. Resultantly, so far as the appeals of the assessee are concerned, the same are allowed while the appeals of the Revenue are dismissed.

Order pronounced in the open court on 27<sup>th</sup> April, 2018.

Sd/-  
**(RAM LAL NEGI)**  
**JUDICIAL MEMBER**

Sd/-  
**(G.S. PANNU)**  
**ACCOUNTANT MEMBER**

Mumbai, Date : 27<sup>th</sup> April, 2018

\*SSL\*

Copy to :

- 1) The Appellant
- 2) The Respondent
- 3) The CIT(A) concerned
- 4) The CIT concerned
- 5) The D.R, "L" Bench, Mumbai
- 6) Guard file

By Order

Dy./Asstt. Registrar  
I.T.A.T, Mumbai