IN THE INCOME TAX APPELLATE TRIBUNAL
SPECIAL BENCH, NEW DELHI

BEFORE SHRI N.K. SAINI, ACCOUNTANT MEMBER,
SHRI PRAMOD KUMAR, ACCOUNTANT MEMBER
AND
SHRI AMIT SHUKLA, JUDICIAL MEMBER

I.T.As. No.1963 & 1964/DEL/2001
Assessment Years: 1997-98 & 1998-99

M/s. Nokia Networks OY, Keialalahdentie 4, Box 300 FIN-00045 Nokia Group, Finland.	vs.	Jt. Commissioner of Income Tax, Non Resident Circle, New Delhi.
TAN/PAN: AAACS 0343R		
(Appellant)		(Respondent)

Appellant by:	Shri Deepak Chopra, Amit Srivastava, Ankul Goyal, Adv. & Shri Arvind Ranjan, CA.		
Respondent by:	Shri T.M. Shiv Kumar, CIT-DR		
Date of hearing:	21	12	2017 & 2/04/2018
Date of pronouncement:	05	06	2018

ORDER

PER AMIT SHUKLA, J.M.:

The aforesaid appeals pertaining to Assessment Years 1997-98 & 1998-99 have been taken up for hearing by this Special Bench in pursuance of direction given by the Hon'ble Delhi High Court vide judgment and order dated 7th September, 2012, passed in ITA Nos. 395 of 2005; 1137 & 1138 of 2006, 503 and 1324 of 2007; and 30 of 2008. The Hon'ble High Court has remanded certain issues back to the Tribunal to be decide afresh as to, firstly, whether the Indian subsidiary of the assessee would provide business connection

or a permanent establishment in India; secondly, even if so, then is there any attributes of profits on account of assigning, networking planning and negotiation of off-shore contract supply in India and if yes then to what extent and basis thereof; and lastly, the question of notional interest on delayed consideration received for supply of equipment and software, is taxable in the hands of the assessee as interest from vendor financing. Before we proceed with the issues which have been remanded back by the Hon'ble High Court to be decided afresh, it would be apposite to deliberate upon the brief facts and background in a succinct manner as culled out from the order of the Hon'ble High Court as well as the material placed on record.

Brief facts and background:

2. The assessee, i.e., Nokia Networks OY (formerly known as Nokia Telecommunications OY), is a company incorporated under the laws of Finland and is engaged in the manufacturing of advanced telecommunication systems and equipments (GSM Equipments) which are used in fixed and mobile phone networks; and trading of telecommunication of hardware and software. In the year 1994 (i.e., on 30.03.1994), assessee had established a Liaison Office (LO) and later on a wholly own subsidiary was incorporated on 23.05.1995, named as “Nokia India Pvt. Ltd” (herein after referred to as Nokia India or NIPL). During the period when LO was in operation, the GSM equipments manufactured in Finland were sold to Indian Telecommunication operators from outside India on principle to principle basis under

independent buyer-seller arrangements as well certain contracts for installation was also entered. After the incorporation of NIPL in May 1995, the installation activities were carried out by the Indian subsidiary under its independent contracts with the Indian Telecommunication operators. The following contracts as culled from the Assessment order were entered by the assessee:-

S.No.	Name of the customer	Date of contract
1.	DTL US (West) Telecommunications Services (P) Ltd.	25.06.1996
2.	Fascel Ltd.	02.06.1996
3.	Tata Communications Ltd.	15.06.1996
4.	Evergrowth Telecom Ltd.	17.10.1996
5.	Modi Telestra (India) Ltd.	23.03.1995
6.	Skycell Communications Ltd.	17.02.1995
7.	Supreme	Not available

In all the aforementioned contracts, the installation activities were performed by the Indian subsidiary under separate agreement entered into between NIPL and the Indian Cellular Operators. In so far as supply/contracts of equipments entered with Modi Telstra (India) Ltd. and Skycell Communications Ltd., the same were signed prior to incorporation of NIPL on 23.05.1995. The installation activities *qua* these contracts earlier form part of the original equipment supply contract but later on were subsequently assigned to NIPL. For the off-shore supply of equipments, the Nokia Finland did not file return of income in India for the

impugned Assessment Years 1997-98 and it was only in response to notice issued u/s. 142(1) on 03.11.1999, that the assessee has filed its return of income on 09.12.1999 without offering any income taxable in India on the ground that it does not have a PE in India, and therefore, in view of the provision of DTAA between India and Finland nothing can be brought to tax in India. It was further claimed that it does not have also any business connection in India as it has supplied goods to Indian Telecom Operators on principle to principle basis, therefore, no income can be taxed in India.

3. The Assessing Officer completed the assessment u/s. 143(3) vide order dated 2.3.2000 in the following manner (as summarised by the Hon'ble High Court):-

(a) Nokia was carrying on business in India through a Permanent Establishment (PE). Both the Indian Liaison Office and Indian subsidiary were held to constitute a PE of Nokia in India. 'Installation PE' was also constituted on the basis that Nokia had supported Indian subsidiary in discharging its obligation under the installation contracts.

(b) 70% of total equipment revenue (comprising of hardware and software) was attributed to sale of hardware and 40% of the same was estimated as income of Nokia from supply of hardware. Further 30% of the profits so determined were attributed to the PE of Nokia in India. The remaining 30% of the equipment revenues were attributed towards supply of software and the same was taxed as 'royalty' (on a gross basis) both u/s 9(1)(vi) of the Income-tax Act and under Article 13 of the India-Finland DTAA, holding that software was not sold but

licensed to the Indian telecom operators.

(c) In addition, income from vendor financing and delayed payment was imputed at Rs.50,000,000/- for each assessment year on account of specific clause in this regard in the offshore supply contracts. The said income was classified as commercial income and added to the income from sale of equipment and licensing of software and taxed at the rate of 55%.

4.1 Accordingly, the addition was made under the following heads:-

(1) Profit on sale of hardware – INR 38,99,98,921

(2) Profit on licensing of software – INR 43,98,48,409

(3) Interest income – INR 5,00,00,000.

5. The finding of the ld. CIT (A) has been summarized by the Hon'ble High court in its judgment in the following manner:-

"*(i) True intention of the contract of supply was not merely to supply the equipment but was also to install and provide related services by or on behalf of Nokia.*

(ii) Nokia was held to have its presence in India in the form of the Liaison Office and Indian subsidiary. 'Installation PE' was also affirmed on the basis that Indian Subsidiary did not act independently in discharge of its obligation towards Indian telecom operators.

(iii) India specific Profit and Loss statement, duly audited by the Auditors of Nokia, was rejected on the basis that Profit and Loss statement was not supported by any documents.

(iv) Profit on sale of equipment (comprising of hardware and software) was arrived at on the basis of net margins disclosed in the global profit and loss accounts of Nokia and 50% of the same was attributed to activities alleged to have been undertaken by Nokia in India.

(v) Income from vendor financing was held to be rightly computed by the Assessing Officer.

(vi) Interest under section 234B of the Act was, however, deleted."

6. From the stage of the ld. CIT (A), the matter had travelled upto the Tribunal wherein the Special Bench was constituted along with other appeals of Motorola Inc. and Ericsson radio systems. The key issues before the Special Bench were following:-

"(a) Whether the Liaison Office of Nokia constitutes a PE in India under Article 5 of the DTAA?

(b) Whether NIPL constitutes a PE in India under Article 5 of the DTAA?

(c) If the answer to Question Nos.1 and 2 is in affirmative, what is the income attributable to the PE under Article 7 of the DTAA?

(d) *Whether income from off-shore supply of equipment can be taxed in India?*

(e) *Whether any income forming part of the consideration for supply of equipment and licensing of software integral thereto is taxable as 'royalty' under section 9(l)(vi) of the Income Tax Act, 1961 or Article 13 of the DTAA?*

(f) Whether on facts and in law the notional interest on delayed

consideration for supply of equipment and licensing of software is taxable in the hands of Nokia?

(g) *Whether interest under section 234B of the Act can be levied on Nokia, being, a non-resident when TDS provisions applied to the sums in question and tax due had not been deducted at source?"*

6.1 These questions have been decided by the Special Bench vide judgment dated 22.06.2005; however, in so far as the appeal relating to the assessee is considered, the following findings have been given by the Special Bench which finding too has been summarized in the judgment of the Hon'ble High Court in the following manner:-

(1) Liaison Office neither constituted a business connection under the Act nor a PE of the Nokia under Article 5 of the India-Finland DTAA, as it merely carried on advertising activities in India.

(2) Sale of hardware took place outside India and no income from sale of hardware accrued to Nokia in India.

(3) Nokia was not responsible for installation of telecom equipment and Nokia's arrangement with the Indian Telecom Operators did not constitute a works contract. NIPL is a separate corporation entity and is also assessed separately for its installation income.

(4) However, Nokia was held to have a PE in India in the form of NIPL, on the basis that Nokia virtually projected itself in India through NIPL and Mr. Hannu Karavirta, acted for both. Losses incurred by NIPL and guarantees given by Nokia that it will not 'dilute its shareholding in NIPL below 51% without written

permission of Indian Telecom Operators was used as the main basis to hold that Nokia was in a position to control and monitor NIPL's activities.

(5) While upholding NIPL as a PE of Nokia, the Special Bench observed that it did not matter that there was no direct evidence for the control of NIPL by Nokia. For purposes of PE, what is relevant is only the perception that NIPL was a projection of Nokia, whether or not in fact and in truth its activities were being controlled/monitored by Nokia. Following discussion ensued on this aspect: -

> *'... We only meant to convey that because of the close connection between the assessee and NIPL, it was possible to look upon NIPL as a "virtual projection" of the assessee in India. We have in fact clarified in the same paragraph that what matters is that there was scope for previewing the assessee's soul in the body of NIPL and that it did not matter that there was no direct evidence for the control of NIPL by the assessee. For purposes of PE, what is relevant is only the perception that NIPL was a projection of the assessee, whether or not in fact and truth its activities were being controlled/monitored by the assessee. Our observations are therefore confined to the question of PE. Otherwise, both the assessee and NIPL remain separate corporate entities and NIPL has also been assessed separately for its installation income. Thus the observations in para 274(b) have no relevant to what has been discussed in this paragraph.'*

(6) Payment for supply of software was not in the nature of 'royalty' because the same was for a copyrighted article and 'not for a copyright. Further, software was held to be integral part of

GSM equipment. Payment for supply of software was held not taxable both under the provisions of the Act and under DTAA.

(7) Interest income from vendor financing was held to have been correctly added.

(8) Following 3 activities were held to have been carried out by NIPL, the PE of Nokia in India:

(a) *Network Planning;*

(b) *Negotiations in connection with the sale of equipment; &*

(c) *Signing of supply and installation contracts.*

(9) 20% of the net profit determined on the basis of the global net profit of Nokia (10% towards signing of the contract and 10% towards other two activities) was attributed to the PE in India. This margin was directed to be applied on the Indian sales of Nokia (clarified by the Special Bench of the ITAT to mean revenues arising from supply of hardware and software).

7. The substantial question of law admitted by the Hon'ble High Court and the final conclusion/answer given by the Hon'ble Court can be tabulated in the following manner:-

Revenue Appeals before Hon'ble High Court (lead case ITA 512/2007)	
Substantial Question of Law admitted by Hon'ble High Court	*Conclusions*
Q1. Whether on a true and correct interpretation of section 9(1)(i) of the Income-tax Act, the Respondent can be said to have a 'business connection' in India in the form of a Liaison Office?	***Decided in favour of assessee*** *(Para 23 of HC Order)*
Q2. Without prejudice, whether the respondent has a 'permanent establishment' in India because of its Liaison Office within the meaning of the relevant provision of DTAA between India and Finland?	

Q3. Whether any part of the consideration for supply of software stated by the Respondent to be integral to the equipment is taxable as 'royalty' either under section 9(l)(vi) or the relevant provision	***Decided in favour of assessee*** *(Para 30 of HC Order)*
Q4. Whether on facts and in law without prejudice, the Tribunal is correct in law in attributing only 20% of the Global Net Operating Profits to the PE in the form of NIPL (Nokia India Pvt. Ltd.) a subsidiary	***Issue remitted back to AO*** *(Para 31 of HC Order)*
Q5. Whether on facts and in law interest under section 234B is leviable?	***Decided in favour of assessee*** *(Para 30 of HC Order)*

Assessee Appeals before Hon'ble High Court (ITA 1137 & 1138/2007	
Q1. Whether on a true and correct interpretation of the relevant DTAAA the Tribunal's reasoning is right in law in holding that NIPL, (the subsidiary of the Appellant) is a permanent establishment?	***All these Issues have been remitted back to ITAT (Para 38 of High Court order)***
Q2. Whether the Tribunal was right in law in holding that a perception of virtual projection of the foreign enterprise in India results in a permanent establishment?	
Q3. Whether prejudice, if the answers to Q.1 & Q.2 are in affirmative, is there any attribution of profits on account of signing, network planning and negotiation of offshore supply contracts in India and if yes, the extent and basis thereof?	
Q4. Whether in law the notional interest on delayed consideration for supply of equipment and licensing of software is taxable in the hands of assessee as interest from vendor financing?	

8. In so far as business connection in India or having a permanent establishment (PE) in India in form of a Liaison

Office (LO) has been decided in favour of the assessee, that is, LO does not constitute any 'business connection' or PE of the assessee in India. Likewise, the consideration for the supply of software which was taxed under the head "royalty" had also been decided in favour of the assessee. The question of law admitted by the Hon'ble High Court in assessee's appeal and the issues which have been remanded back to the Tribunal, have been dealt by the Court in the following manner:-

"34. We may recapitulate that there are four contracts which have been referred to in the orders of the authorities below. The same are:

i. Supply contracts between the assessee and various customers.

ii. Installation Contracts between the Indian subsidiary and the customers directly. Only two contracts with Modi Telstra and Skycell executed in February and March, 1995 were separate from the supply contracts and installation portion was assigned to the Indian subsidiary with the consent of all concerned.

iii. Marketing support Agreements dated 19.4.1996 and 6.11.1997 between the assessee and its Indian subsidiary, and

iv. Technical support agreement between Indian subsidiary and the customers.

Whereas the marketing support ensures to the benefit of the assessee the technical support ensures to the benefit of the Indian customer, the technical support is in respect of the

projects installed and has nothing to do with the supply contract. The consideration accruing or arising under the contracts already assessed in the hands of the Indian subsidiary and there is no adverse action in respect thereof. The technical support agreement referred to supra has not even been referred to by the authorities below in support of any of the allegations. Only general or loose reference has been made by the Tribunal. The dispute hence only pertains to the consideration under the Supply Agreement entered between the assessee and the various customers.

35. It was the submission of Mr. Syali that although the Tribunal held that with the Indian subsidiary there was a business connection, they did not go into the issue of how much income can be attributed to the activities carried out in India because that analysis was only made in respect of the subsidiary constituting a PE. Even though a business connection exists, if there is no income accruing or arising directly or indirectly through or from that business connection in India, nothing can be taxed in the hands of the assessee. It was the argument of Mr. Syali that Section 90(2) of the Act clearly stipulates that the treaty regime can be opted if it is more beneficial to the assessee and, therefore, it was necessary to ascertain as to whether any income was attributable to the PE. It was argued that no such income could be attributed to PE in India and these aspects were not correctly appreciated by the Tribunal. Learned Senior Counsel submitted that the conclusion arrived at by the Tribunal was erroneous as it was based on various factual errors has crept in the orders of the lower authorities. According to him, the factual errors of the orders of

the AO were specifically pointed out in the submissions to the CIT (A) and specific grounds were also taken before him which are as under:-

(i) The Indian subsidiary was executing contracts on behalf of the appellant through its employees.

(ii) All the contracts with the operators were signed in India.

(iii) *The employees of Indian Office (LO) were compensated by some other entity.*

(iv) *From 1996 onwards all the expenses of Indian office were shifted to the Indian subsidiary.*

(v) *The employees of the Indian office were responsible for execution of the contracts with operators.*

(vi) No compensation was paid to IC for marketing and support services prior to 1997.

(vii) PSC was set up in India to supervise the supply contract with TATA.

(viii) Certificate of acceptance was signed by Indian subsidiary on behalf of the appellant.

(ix) *The appellant has accepted that the license of customized software is not sale, but royalty, and*

(x) *The appellant has actually earned interest from Vendor Financing and on account of delayed payments by the operators in the relevant previous year.*

36. Mr. Parasaran, learned ASG appearing for the Revenue could not controvert the aforesaid pleas of Mr. Syali. We find that the aforesaid errors on facts have crept in. It is primarily for the reason that the Tribunal had taken the facts in the case of

Ericsson case and on the presumption that those facts were common the case of Nokia as well and the legal questions in the appeals of Nokia were decided therefore the actual inaccuracy has crept in the fact findings of the Tribunal. We find justification in the argument of Mr. Syali that the clear cut impact of such assumptions is evident from the fact that findings (i), (iv), (v) and (vi) are all suppositions in the absence of appreciating that there was a marketing support agreement in operation from 1.1.1996 to the 31-12.1996. Even as per the AO after the later agreement of 1997 there is no allegation made as regards shifting of expenses, no compensation paid to Indian subsidiary, etc. in other words, once there was an agreement the issue only revolved on the nature of the agreement. Once it is accepted that the position in 1997 and 1996 is pari-materia, there will not remain any such allegation.

37. We would like to record that the CIT (A) proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability. The CIT (A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian subsidiary did not occur at arm's length. Mr. Syali argued that there was no basis for drawing such inference and at the time of arguments, the learned ASG conceded that there was no evidence to support that losses were absorbed by the Indian company. Again, pertinently, the Tribunal also observed that NIPL could be considered PE of assessee in India being subsidiary as it is the virtual projection of the company in India. Further, the accounts of the Indian subsidiary show that the "company incurred huge

losses as it was not compensated properly for the installation work carried on by it. In the opinion of the ITAT since it was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary. The learned ASG also conceded that it was not correct.

38. As we find that the order of the Tribunal is based on many factual errors which are even accepted by the Revenue before us, it would be appropriate to refer the matter back to the Tribunal for fresh consideration on the issues as to whether the subsidiary of the assessee would provide business. connection or is Permanent Establishment and even if it is so, is there any attributes of profits on account of signing, under working, planning and negotiation of off-shore supply contracts in India. If yes, to what extent and basis thereof. Likewise, the question of notional interest on delayed consideration of supply of equipment and liaisioning of software taxable in the hands of assessee as interest from vendor financing would be considered afresh. The appeals of the assessee are thus disposed of with the aforesaid direction remitting the case rack to the Tribunal for fresh consideration on these issues."

9. From the aforesaid observations and the directions of the Hon'ble High Court, the scope of adjudication by this Tribunal is limited to following questions:-

(a) Whether the subsidiary of the assessee (NIPL) would provide business connection? Or whether the same constitutes a permanent establishment of assessee in India?

(b) And if the answer to above question is found to be affirmative, then whether any attributes of profits on account

of signing, network planning and negotiation of off-shore supply contracts in India could be attributed to such business connection/ permanent establishment.

(c) Whether notional interest on delayed consideration of supply of equipment and licensing of software taxable in the hands of assessee as interest from vendor financing.

10. We shall now first take up the key issue, whether the Indian Subsidiary, Nokia India Pvt. Ltd. (NIPL) constitutes PE of Nokia Networks OY in India and/ or whether the said subsidiary would provide business connection in India. First of all, we have to analyse the case of the Assessing Officer. The primary case of the AO *qua* the Indian subsidiary was that, it constitutes a Dependent Agency Permanent Establishment (DAPE) of the assessee in India. However, the finding of the Assessing Officer is scattered at various places where he has taken into account several facts and has mixed up the entire concept of PE in as much as while holding LO as a PE, at the same length and based on same material facts has treated NIPL as a PE of assessee in India. In so far as the LO is concerned he has treated it to be a fixed place PE, however so far as Indian subsidiary is concerned he has treated it to be a DAPE. We shall discuss in brief the relevant observations made by the learned Assessing Officer and analyse his finding with factual clarification and analysis based on material placed on record, which has been extensively referred to during the arguments raised by the parties before us.

Findings in the assessment order:

11. At page 2 of the assessment order, Assessing Officer has noted that assessee has supplied hardware and software to the following companies under following contracts:-

(a) BPL US (West) Telecommunication Services Pvt. Ltd.	26.06.1996
(b) Fascel Ltd.	2.06.1996
(c) Tata Communications Ltd.	15.06.1996
(d) Evergrowth Telecom Ltd.	17.10.1996
(e) Modi Telstra India Ltd.	23.3.1995
(f) Skycell Communication Ltd.	17.2.1995
(g) Supreme	No written contract

The details of these are available at page 203 of the paper book filed by the assessee which also provides the details of the persons who has signed these supply contracts with Indian customers. From the details given at page 203, it emerges that contracts with Modi Telstra India Ltd. (pages 128 to 174) and Skycell Communication Ltd. (pages 175 to 348), were signed by Mr. Hannu Karavitra in the capacity of Country Manager employed in LO and contract at serial nos. (a) to (d) were signed by the expatriates who were the employees of the assessee company. As noted by the Hon'ble High Court also the LO was opened in the year 1994 when Mr. Hannu Karavitra was a country manager, therefore, the two contracts signed in the month of February, 1995 were signed by Mr. Hannu Karavitra in the capacity of Country Manager of the LO and why this vital fact is relevant shall be discussed in detail in the later part of the order. The

Assessing Officer while rejecting the assessee's claim that its income arising from offshore supply of hardware and software were not taxable in India since there was no PE of the assessee in India, he has proceeded with following premise:-

i) In fact the project was turnkey project and the assessee has divided these contracts for its own convenience and to avoid its taxability in India.

ii) Nokia Telecommunications OY has a permanent establishment in India in the form of its Indian Office.

iii) The assessee has an Indian Subsidiary which is a dependent agent PE.

iv) The software has been supplied under a license and it has not been sold and therefore, the income is in the form of 'Royalty'.

v) The Indian company has not been compensated properly for the services rendered by it to the assessee company.

vi) The value of installation contract in many case is lower than the normal cost of installation as prevalent in the market at that time.

12. In so far as the issue of turnkey/composite contract referred to at various places by the Assessing Officer, the same are no longer matter of adjudication, because they had been made in reference to Modi Telstra contract which have been discussed in the context of LO being PE in India and this matter has attained finality from the stage of the Hon'ble High Court, that is, LO has held to be neither having business

connection in India nor having any kind of PE in India in terms of Article 5.

13. However we shall briefly discuss certain facts which has been noted by the Assessing Officer *qua* the LO in India so as to constitute it as a fixed place in PE but has been also harped upon the department for NIPL also. In the assessment order, the Assessing Officer's observations can be summarised in the following manner:-

(a) The LO was opened in 1994;

(b) Mr. Hannu Karavirta was the country manager and has signed the accounts of the LO;

(c) In the year 1994 he has signed the balance sheet as country manager;

(d). He has signed the contracts on behalf of the assessee on 17.2.1995 with Skycell;

(e) This clearly establishes that the Indian office (LO) was a permanent establishment of the assessee where employees were signing contracts on behalf of their principals;

(f) Same person Hannu Karavirta was the country manager of the LO and subsequently he was the managing director of the Indian subsidiary in 1997-98. This fact proves beyond doubt that the Indian office was not merely a liaison office but a proper office where contracts were signed and terms negotiated;

(g) While working in India Hannu Karavirta was receiving salary from assessee;

(h) Without prejudice to holding that NIPL was a DAPE of the assessee, the AO had observed that the Indian office (LO) was a fixed place PE being a place of business of the assessee and was marketing the assessee's products;

(i) The LO provided an interface between the customer and the assessee and also the office of the LO was co-located with that of NIPL;

(j) LO was also a fixed place PE, because before the contracts were signed a number of expatriates came to India, stayed in India and carried out network planning and they were also involved in negotiation with various customers and interacting with them on a regular basis. This would not have been possible with the assessee having a fixed place of business in India which was the liaison office together with the office of the Indian company;

(k) The Managing Director of NIPL has confirmed in his statement recorded during the course of assessment that various kinds of administrative support was provided to the visiting expatriate employees of the assessee;

(l) Hannu Karavirta signed contracts on behalf of the assessee as well as the Indian company as he was the country manager of NIPL from 1.2.1994 to 31.12.1994 and Managing Director of NIPL 1.1.1996 to 31.7.1999.

In so far as the employees' details of Mr. Hannu Karavitra which has been extensively referred to by the learned Assessing Officer, we find that his employment details in NIPL and the periods as well as designation of his employment are contained at page 369(10) (of the paper book of volume III)

which reveals that he has been employed as country manager in LO from 01.02.1994 to 31.12.1994 and thereafter from 01.01.1995 till 13.12.1995 he was not employed with Indian company. He was employed with a NIPL as its managing director from 01.01.1996 to 31.07.1999. Mr. Hannu Karavitra has signed the Modi Telstra contract on behalf of the assessee on 23.03.1995 and Skycell on 17.02.1995 on which point of time he was not employed with NIPL. There is also an observation in the assessment order that he was the country manager of NIPL from 01.02.1994 to 31.12.1994, which fact is divorced from the material facts as NIPL itself came into existence only from 23.05.1995 and hence he could not have been employed with the Indian Company. There is also a reference of assignment letter dated 24.05.1995 signed by Mr. Hannu Karavitra whereby off shores services were assigned to NIPL and at that time he was employed with LO and not with Indian Company. In any case the assignment was from the assessee to the Indian company. The Assessing Officer has further observed that Mr. Hannu Karavitra was representative of the assessee as well as the Country Manager of NIPL from where he has tried to draw an inference that the assessee through its employees constitutes a PE in India. But nowhere Assessing Officer has tried to bring out on record that after he became the managing director he has signed any supply contracts on behalf of the assessee in India. The details of supply installation contracts and after sales services contracts which have also been given at page 19 of the

Department's paper book are as under:-

Name of customer	*Supply*	*Installation*	*After sales service*
Tata Telecommunications	*Nokia Finland*	*Nokia India*	*Nokia India*
BPL US	*Nokia Finland*	*Nokia India*	*Nokia India*
Evergrowth Telecom	*Nokia Finland*	*Nokia India*	*Nokia India*
Modi Teslstra	*Nokia Finland*	*Nokia India*	*Nokia India*
Skycell	*Nokia Finland*	*Nokia India*	*Nokia India*
Fascel	*Nokia Finland*	*Nokia India*	*Nokia India*

From the aforesaid installation contracts and the dates of the contracts as noted earlier, it emerges that the expatriates, i.e., the employees of the assessee who have been visiting India and doing network planning, negotiating and signing the contracts on behalf of the assessee were in the context of the LO and after the NIPL was incorporated entire installation activities and after sales services have been done by NIPL. Since LO has already been held to be not constituting a PE by the earlier Special Bench and also confirmed by the high Court, ostensibly the same does not have any relevance while deciding the issue of PE *qua* the Indian subsidiary (NIPL).

14. Learned Assessing Officer has also extensively quoted the statement of the Managing Director recorded by him that administrative support services were provided to the visiting expatriates of the assessee, but as clarified by the Ld. Counsel before us that same has reference in the context of the position after 1996 when the marketing agreement was signed between the assessee and NIPL. One of the main contentions

of the Ld. Counsel has been that NIPL only provides support services, like telephone, fax, conveyance, etc. The copy of the statement of the MD of NIPL has been placed by the learned CIT-DR in the paper book filed before us at pages 20 to 24 and from there it has been tried to canvass before us that, nowhere in the said statement has he admitted that NIPL has entered into any kind of supply contract of equipments on behalf of the assessee nor has it made available any place leave alone fixed place to the expatriates (employees of the assessee company). Analysis of the statement of the Managing Director of NIPL shall be dealt in the later part of this order.

15. Now in so far as the facts noted by the AO *qua* the Indian subsidiary so as to constitute a PE, first of all, Assessing Officer has noted that it is wholly owned subsidiary of assessee and it is a DAPE of assessee. At page 15, Assessing Officer further records that the LO though was opened in 1994, but during the year under consideration, the assessee spent amount of Rs.3 crores on rent and no salary or perquisite have been charged to the LO which means that employees where compensated by some other entities. He also notes names of some 10 employees of the LO from where he deduced that these were the employees of the LO but salary were being paid through NIPL and it was on paper only that these were shown as separate companies but actually the Indian company was nothing but the extension of the assessee. He further noted that in the accounts of the LO for the period ending on 31st December, 1995, there was an

expenditure of Rs.5 crore on the LO, but suddenly from 1996 onwards the expenditure has been shifted to the Indian company and the Indian company has not got any compensation for the same. This shows the close business connection between the subsidiary and the assessee. He further observes that during the Assessment Year 1998-99 the assessee had signed a marketing agreement with the Indian company, i.e., NIPL and as a part of this contract, NIPL was to provide consultancy and advisory services as well as commercial and industrial information to the assessee and for coming to this conclusion he has extensively referred to clauses of the said Agreement. He has also observed that Indian company which was reimbursed on cost plus basis (cost plus 5%) was not in accordance with industry norms and was also not based on arm's length principle. While examining the NIPL to be a DAPE of the assessee, he observed that the Indian company provided all services like market development, customer meetings, customer interactions and many other services but the company was not compensated by the principal, i.e., assessee and also NIPL provided space for expatriates in as much as it provided telephone and fax facilities for which NIPL did not charge the assessee. However, at the same breath the Assessing Officer has admitted that foreign expatriates have been coming for signing of contracts and meeting their customer during the network survey and planning which cost was absorbed by NIPL and nothing was charged from the assessee. The AO has further observed that

employees of the Indian office were providing marketing services during the year and were also responsible for execution of the entire contract. He also held that the employees of the Indian company were accompanying the expatriate employees during the meetings with the customers. This fact particularly assumes great significance as the assessee has been strongly contending that it was the expatriate employees of the assessee who were visiting India for negotiations and signing of contracts and the Hon'ble High Court too while remanding the matter had directed this Tribunal to determine the PE exposure in respect of NIPL for signing, network planning and negotiation of contracts. Such an observation of the AO that these activities were being done by the visiting expatriates would be relevant in deciding the NIPL being a fixed place PE or DAPE of the assessee. Thereafter, the AO refers to a statement of the managing Director of NIPL and from this statement, the AO concludes that from 1.1.1997 rent was also not paid by the LO and the same was taken over by the Indian office (NIPL) and thus he concludes that the Indian company has completely absorbed the cost on behalf of the assessee. From page 21 onwards of the assessment order, the AO highlights his reasons for treating NIPL as DAPE of the assessee, which in sum and substance can be summarised as under:-

a) NIPL is a dependent agent as per the provisions of the DTAA. Although it has concluded contracts with various cellular operators for installation and service, it becomes

the non-resident responsibility to get the contracts executed by the Indian company. The Assessee has issued guarantee to Indian customers that it will get the contracts executed by NIPL; and assessee has assured that it will not dilute its equity in NIPL less than 51%.

b) Contracts provide that installation work will be done by the Indian company and any notice under the installation contracts should also be sent to the assessee.

c) All the contracts are signed in India and the employees of the Indian company have attended meetings at the time of finalisation of such contracts and have signed the contracts as witnesses.

d) Responsibilities of the assessee in respect of minimisation of container detention charges were taken over by NIPL.

e) Assessee has given a 12 month warranty and warranty services were being provided by Indian company's employees.

f) Clause 8.2 referred to by him at page 23 of the assessment order refers to an independent arrangement between NIPL and TATA Cellular.

j) Expatriate employees of NIPL were responsible for installation work, who were employees of the assessee or its associates and this proves that the assessee was to provide necessary assistance, information, knowledge and expertise to do the installation work.

k) NIPL has made a loss and has not been paid any compensation by the assessee and this proves that NIPL was dependent agent of the assessee.

l) The Indian company is dependent on the assessee as the assessee has total control over the management and affairs of the Indian company.

m) The most important factor to prove that the Indian company was a DAPE of the assessee that it signs the acceptance test certificate. This clearly shows that the contract does not get completed till it gets accepted by the purchaser. These facts prove that the contract is actually executed by the Indian company as a nominee of the assessee.

n) On page 30 of the order the AO held that the contention of the assessee that title has outside India cannot be accepted.

o) Assessee has provided project steering committee to monitor.

p) Acts of the Indian company are binding on the assessee.

q) Another important factor is the person who has signed the contracts on behalf of the Indian company and the assessee on 25.6.1996, that is, he has signed between NIPL and BPL US (West) and the same person has signed a letter dated 24.5.1995 assigning the contract on behalf the assessee to NIPL. The installation contract dated 23.3.1995 between Modi Telstra and assessee has been

signed by the same person. He was the authorised signatory of both the LO as well as the Indian company;

r) The Indian company has worked wholly and exclusively for the assessee and provided installation services to customers whom the assessee had supplied equipment.

In view of the aforesaid reasoning, AO has held NIPL to be PE of assessee in India.

Findings of CIT (Appeals):

16. Ld. CIT(A), first of all in the context of assessee having a business connection in terms of Section 5 r.w.s. 9 of the Act had made his observations in paragraph 5.2 of his order, which for the sake of ready reference is reproduced herein below:-

> *"We may now proceed to decide whether income accrued or arose to appellant in India under sec. 5 or it can be deemed that it accrued or arose to it u/s 9, Section 5 speaks of the situs of accrual of income, but it does not provide any guideline to decide the situs. The cases on the issue also do not lay down any firm guidelines. The general proposition is that the place of formation of contract, the place of activities and all other attendant circumstances need to be taken into account for deciding this matter. The place of signing of the contract may not be conclusive of the matter. Similarly, the place of the carrying on the contract may also not be conclusive in this behalf. When we look to assessee's operation in India, it can be said that it sold goods to the Indian operators. It had a branch office in India for carrying*

out marketing operations. Its employees came to India with a view to design the GSM and thereafter the contracts for sale of goods and licensing of software were made. The responsibility of the assessee did not stop there. The Indian operator had a right to make visual inspection of the equipment stored in India in appellant's warehouse or the warehouse of IC. The idea was to check whether there was any damage to the goods in the course of transportation. If such a damage was visually noticeable, the appellant was required to replace the damaged goods. This means that the transportation risks in the goods were not passed on to the Indian buyers' at the foreign port. Therefore, the case of Mahabir Commercial Co. is not applicable to the facts of this case. The reason is that in that case that the bill of lading was taken in the name of seller to secure payment. In the instant case, the appellant was responsible for safe passage of the goods in transit and, therefore, it cannot be said that all risks in goods were transferred to the Indian operators at the foreign port. Further, as seen from the agreement, the contract was not merely a contract for sale of goods. It was a contract for setting up GSM for the Indian operators. It is no doubt true that the installation work assigned to and undertaken by the IC. However, the Ld. A.O. has reproduced in the assessment order, on pages 7 & 8, a letter written by the assessee to Tata, in which the assessee guaranteed the due and timely discharge and performance, in accordance with the service contract of the IC, of all obligations and liabilities of the IC. Not only that, it also confirmed its plan and intention to provide all assistance to IC in the event that it should be required at any time, in another letter reproduced on pages 8 & 9 of the order. The assessee

had also undertaken that so long as the agreement remains not performed, the stake of the assessee in the IC will not be reduced below 51% without the written permission of the Indian operator. In this letter it was also held out that the assessee has already provided or will provide to the IC with all specialist resources, skill, training, documentation and technical assistance, it may from time to time require in order to meet its commitments. These letters clearly show that not only the IC was a wholly owned company but it was under close control and supervision of the assessee in regard to conduct of its business. The A. O.'s observation that all the employees and expenditure of the Indian office were shifted to the IC should be taken in the light of these facts. On the basis of those facts, it will not hard to conclude that the assessee carried on business on continuous basis initially through it's LO and later through the IC. In its representation regarding accrual or deemed accrual in India, the appellant as well as the A. O. have mixed up the issues of business connection and PE. We are presently on the issue of business connection or accrual of income to the appellant directly u/s 5(2) and 9. All the facts and circumstances suggest that the assessee carried out business in India, which was not merely preparatory or incidental in nature. The designing of the GSM is not the incidental activity, without which the business of the assessee could have been carried on. In fact it was the heart of the activity but for which even the requirements of Indian operator could not have been listed out. The requirements were worked out on the basis of design and thereafter the equipment was supplied and the software was licensed. The assessee always had the presence of its office or the office of IC to aid it in its

activities. Thus, it is not a bald case of mere sales. Many more activities were required and done for setting up GSM for Indian operators. Accordingly it is held that income accrued directly to the appellant, u/s 5(2). and it also can be deemed that income accrued to it through its office in India or the office of IC in India."

17. Thereafter in paragraph 6.3 examining the taxability under the DTAA and Indian subsidiary, NIPL is a PE in India, he had made following observations in paragraph 6.3, which again for the sake of ready reference are reproduced herein below:-

"6.3 The assessee had also a wholly owned subsidiary in India. It has been pointed out earlier that representation was made to the Indian operators that the assessee would to ensure that the installation contract was carried out fully by the IC, and the assessee would fully support the IC in discharge of its obligations under the contract. Not only that it was also represented that the assessee will not dilute its activity below 51% in the IC without the written permission of the Indian operator. In view of these representations and the counter undertakings given by the assessee and the IC, it cannot be said that the IC acted independently in discharge of its obligations under the contracts. In the course of appellate proceedings a copy of the order in case of the IC was filed. According to this order the company incurred book loss of about Rs.10 crore. Even if the depreciation of about Rs.3 crore is ignored then the loss before depreciation would about Rs.8 crore. The IC had two streams of income, namely, commission

from the assessee under the marketing agreement and installation charges from the Indian operators. The case of the assessee was that in respect of marketing agreement, the IC was compensated on cost plus 5% basis, which was claimed to be reasonable. If this argument is taken to be correct, then it can be said that the loss occurred on account of installation contracts. In other words, it lends credence to the A.O.'s assertion that the IC was not properly remunerated under the contracts, guaranteed by the appellant and a part of money that it ought to have got was diverted as sale proceeds of the equipment. Nonetheless, even if this argument is rejected, the fact is that the IC incurred substantial loss and, therefore, it was not properly remunerated for the services rendered by it either in respect of marketing agreement or in respect of installation contract. The IC is a wholly owned subsidiary of the appellant and, therefore, appellant was in the knowledge of prices put on the installation contracts. It had wide experience in this line of business and yet the IC undertook business in a manner that it incurred substantial losses. Therefore, it cannot be said that the transactions between the assesse, the operator, and IC were at arms' length. In fact the agreements by the assessee with the Indian operators on one hand and IC with the Indian operators on the other can be said to have been arranged in a manner that loss would be incurred to the IC. In view thereof, there is reason to hold that the IC constituted the PE of the assessee and observed losses on behalf of the assessee. In the context of these facts, it will be difficult to hold that the assessee and the IC acted independently in so far as their businesses are concerned and it will more appropriate to hold that the IC merely acted at the

instructions of the assessee in respect of installation and marketing contracts. It was also the case of the assessee that certain averments in Appendix 6 to the effect that Indian subsidiary assumed responsibilities on behalf of the appellant for timely supply of equipment were wrongly made. But no evidence has been filed that the written agreement contained inaccurate statements. We have also seen that the appellant himself has taken up the responsibility on behalf of the subsidiary company and has gone to the extent of holding out that its equity will not be diluted below 51% till installation contract is completed, except with written permission of the Indian operator. This strengthens the view that the assertions of the assessee in the (illegible) not correct. Accordingly, it is held that the Ld. A.O. was right in holding that the appellant had a PE in India through the office of the I.C."

18. Lastly, on the issue of attribution of income from supply of equipment, Ld. CIT (A)'s finding in paragraph 7 is reproduced hereunder:-

"7. *Coming to the issue of the computation of income on sale of hardware, the Ld. A. O. observed that the gross profit of the assessee was 28.7% while the operating profit was 10.8% in the year ended on 31.12.96. However, thereafter, without assigning any reason he estimated the profit margin on sale of hardware at 40% of the total sales. The view of the Ld. Counsels was that the Indian Telecom Industry had been passing through a bad phase in that period and Indian operators were incurring heavy losses. The assessee was a new entrant in this highly competitive market and it had to*

make significant initial investment for gaining market share. Copies of P&L a/c for Indian tax purposes for financial years 1996-97 and 1997-98 were filed in the paper book as item 6 of section 3. This showed a loss of U.S. dollars 2,37,52,669 for the year ended 31.3.97. The sales were shown at U.S. Dollars 1,57,51,991 . On the face of it, there appears to be something wrong with the P&L a/c as direct costs were shown at U.S. Dollar 2,10,24,054. This is in the context worldwide gross profit of 28.7%. This P&L a/c was not substantiated with any documents. Therefore, it is held that these accounts are not reliable for the purpose of computing income from sale of hardware. Accordingly, assistance of Rule 10 of the I.T. Rules is taken to compute profit on the basis of global accounts. The global accounts showed net profit of 10.8%, as mentioned by the Ld. A.O. in the assessment order. Therefore, the net profit is taken at 10.8%. The whole of this profit cannot be attributed to Indian operations as activities regarding manufacture and development of products etc. was undertaken outside India. Therefore, the attributable to operations in India are taken at 5% of the sales to the India parties."

19. The erstwhile Special Bench has held that so far as the LO is concerned, it neither provided any business connection nor constituted a PE of assessee in India, which matter as reiterated above has attained finality from the stage of the Hon'ble High Court. So far as the Indian subsidiary is concerned (NIPL), Special Bench held that same was a virtual projection of the assessee in India and hence, not only afforded a business connection but also constituted

assessee's PE in India. On attribution of income, the erstwhile Special Bench has held that only following activities were carried out by assessee's PE in India, viz.,;-

- *Firstly*, network planning;
- *Secondly*, negotiations in connection with sale of equipment; and
- *Lastly*, the signing of supply in installation contracts.

After considering the nature of activities and citing various judicial precedents the Special Bench was of the view that 20% of the net profit in respect of Indian sales needs to be attributed to PE in the form of NIPL. It was on this final conclusion both assessee and Revenue had gone in appeals before the Hon'ble High Court which have been adjudicated in the manner discussed above and also the issues which have been remitted back to this Tribunal.

Arguments on behalf of the appellant/assessee:

20. Before us the learned counsel on behalf of the assessee, Mr. Deepak Chopra submitted that the Hon'ble High Court has directed with specific scope of examination by this Special Bench for the fresh consideration as to whether Indian subsidiary of the assessee would provide business connection or is it's PE in India; and if there is such business connection or PE, then the attribution of profits and that to be only on account of signing, networking, planning and negotiation of off-shore supply contract in India. It is within this scope

circumscribed by the High Court, this Tribunal has to see first of all, the issue of business connection under the domestic law, i.e., whether the non-resident assessee was taxable in India in respect of profits arising from off- shore supply of telecommunication equipment to its customer who are Indian cellular operators. In respect of assessee having any kind of business connection in India, he strongly relied upon the judgment of Hon'ble Delhi High Court in the case of **Nortel Network India International Inc. vs. DIT (2016) 386 ITR 353,** for the proposition that even it is assumed that there existed the business connection of assessee in India in view of the *Explanation* to Section 9(1), then also, no portion of the profits from off-shore supply could be brought to tax in India giving the fact that no activity of off-shore supply was carried out in India. He further referred and relied upon the judgments of Hon'ble Supreme Court in the case of **Ishikawajima Harima Heavy Industries Ltd. vs. DIT (2007) 288 ITR 408 (SC);** and **CIT vs. Hyundai Heavy Industries Company Ltd. (2007) 291 ITR 482 (SC)**. Relying on these judgments, he submitted that if the taxability does not arise under the domestic law, i.e., under the provision of Income Tax Act itself, then there is no requirement to examine the provisions of DTAA. In this context, Ld. Counsel has relied upon the judgment of Hon'ble Delhi High Court in the case of **Linde AG vs. DIT, 365 ITR 1**, wherein the Hon'ble High Court has observed that DTAA do not contain any charging provision by virtue of which income tax is levied, because tax

is charged by virtue of Section 4 r.w.s. 5 and it is only in the event that assessee is liable to pay tax under the Income Tax Act that the question of examining, whether the assessee is entitled to any benefit under the relevant DTAA would arise. If an income is not liable to tax under the normal provision of the Act then it would not be brought to tax only by virtue of DTAA. He submitted that in the context of the LO, the Hon'ble High Court in the case of the assessee on the issue of off-shore supply of telecommunication equipment has held that there is no business connection in India. The same principle and ratio will apply in the case of NIPL also, because so far as the off shore supply of equipment is concerned, NIPL had no role to play at all. He submitted that one of the key allegation of the Revenue had been that one of the employee of the assessee company, Mr. Hannu Karavitra was the country manager of the LO and was also the Managing Director of the assessee company, who was negotiating the contract for supply of equipments and not only that in the official capacity of representing a NIPL, he has also carried out installation activities. In this regard, he specifically clarified that Mr. Hannu Karavitra was employed as a Country Manager of the LO prior to the incorporation of NIPL in May, 1995 and when he became the employee of NIPL from 1.1.1996 onwards, no such negotiation of supply contract was undertaken by him at all. The two contracts which were signed prior to incorporation of NIPL were done by him on behalf of the assessee in the capacity of Country Manager of LO and now

that issue has been set at rest and there is no iota of evidence that after the incorporation of NIPL, he has negotiated any kind of contract for assessee for supply of equipment (i.e., when NIPL came into existence). The installation activities and on shore services assigned to NIPL were carried out by NIPL solely on principal to principal basis with Indian customers and it is completely an independent activity for which NIPL is subject to tax in India and assessee company has no role whatsoever to such activities. He further submitted that the supply of equipments made outside India with independent customers and no part of it or any kind of activity *qua* the supply contract was carried out in India so as to hold that assessee had any business connection in India in the name of NIPL. Thus, he submitted that under the domestic law itself nothing can be brought to tax.

21. Without prejudice, he submitted that, in so far as the issue whether there is an existence of a PE in the form of NIPL, the scope of inquiry and examination in terms of Article 5 of DTAA should be confined only to the issue of existence of DAPE, because the entire case of the Assessing Officer vis-à-vis NIPL is that, it is dependent agent of assessee and it was in the context of LO that he has held that assessee had a fixed place of business and hence it is a fixed PE in India. In the context of a NIPL there was no such allegation of the Assessing Officer that it constituted a fixed place for off-shore business of the assessee in India. In so far as fixed place of PE *qua* the LO, he reiterated that same now cannot be raked

up in the present proceedings which is in pursuance of the directions and the scope of remand by the Hon'ble High Court. He submitted if in the case of LO such activities have not resulted in fixed place of business or PE, then how the same activities could be reckoned that NIPL will constitute a PE of the assessee in India. Thus, the concept of DAPE has to be seen and not the fixed place of PE. In the context of DAPE, he submitted that one of the basic conditions in terms of Article 5(5) is that, the dependent agent has habitually exercised authority to conclude contracts in India in the name of enterprise. Ostensibly from the facts, it is clearly evident that at no point of time NIPL was negotiating or concluding any contract for the supply of equipment in India for the assessee which binds the assessee for honouring such contract. Time and again, the Department has harped upon the fact that the NIPL had an authority to conclude contract which inference has been drawn from two supply contracts signed by one, Mr. Hannu Karavitra who at that time was an employee of LO and after incorporation of NIPL became an employee of the Indian subsidiary who had also signed the installation contracts on behalf of the NIPL. Clarifying this aspect he submitted that the contracts which were signed by him earlier only pertained to Modi Telstra India Ltd. and Skycells Communication Ltd. which was prior to the existence of NIPL and after he came into roll of NIPL, he did not sign any contract with any Indian customer for the off-shore supply. He has only signed installation contracts on behalf of

the Nokia India. He drew our attention to page 203 of the paper book, where the details of the supply contracts with the Indian customers along with the details of persons signing the same has been provided and from there he pointed out that no such supply contracts were signed by the NIPL. Thus, the basic condition contained in Article 5(5) that the dependent agent has habitually exercises the authority to conclude the contract does not get satisfied on the facts of the present case. Nowhere in the assessment order or in the appellate order there been allegation that NIPL has signed any contract on behalf of the assessee so as to satisfy the condition of Article 5(5). The only contracts which have been signed by the NIPL are installation contract which were executed by NIPL only. The Assessing Officer has tried to bring on record to establish that NIPL was DAPE on the footing that it was in complete control of the assessee and was subjected to its instruction. He submitted that such an observation of the Assessing Officer cannot be a relevant consideration for the creation of PE under Article 5(5). Further clause (i) of Article 5(5) provides that where the activities of the agents are restricted to the activities listed in Article 5(4), it would not create a DAPE. Thus, where the activities of assigning of contracts, network planning and negotiation of off-shore contracts has been held to be preparatory and auxiliary in nature, then it cannot said to have satisfied the threshold of being DAPE under Article 5(5). Even otherwise also, he submitted that the concept of “virtual projection” has no place

while determining the DAPE under Article 5(5).

22. In so far as the contention of the Revenue that NIPL is 100% subsidiary of assessee and therefore, it is a PE of assessee in India, he submitted that Article 5(8) of the India-Finland DTAA specifically provides that mere control over the subsidiary does not result in creation of a PE. Simply because assessee is having a subsidiary in India will not *ipso facto* constitute a PE. Thus, in terms of Article 5(4) r.w.s. Article 5(5) and Article 5(8), the NIPL cannot be reckoned as DAPE.

23. Coming on to the issue of fixed place PE under the Article 5(1), Mr. Deepak Chopra submitted that, first of all, it was never the case of the Department that NIPL constitutes fixed place PE at all; and secondly, even if NIPL has to be seen in the context of Article 5(1), then also on the facts and material on record, it does not constitute a fixed place PE. The reason being that, the essential test which has been laid down now by the Hon'ble Supreme Court in the case of **Formula One World Championship Ltd. vs. CIT, reported in 394 ITR 80 (SC),** is that the place of the business should be at the disposal of the assessee which is absolutely lacking in the present case. The term *'at the disposal'* cannot be merely reckoned as giving an access of a place but such a place should be 'at the disposal' of the enterprise, that is, when the enterprise has the right to use the said place and has control thereupon. No such evidence is brought forth that office of the Indian subsidiary was at the disposal of the

assessee qua its activity relating to supply contract. He also drew our attention to various paragraphs appearing in the said judgment and submitted that Hon'ble Apex Court after referring to various commentaries of the eminent international authors and the judicial precedents, have laid down one fundamental principle that to ascertain as to whether an establishment has a fixed place of business or not, is that physically located premises have to be at the disposal of the enterprise. Nowhere the Hon'ble Supreme Court has given up the 'disposal' test while considering the concept of a fixed place PE. The Hon'ble Supreme Court at best has only diluted 'permanency test'. This principle laid down by the Hon'ble Apex Court has been further reiterated and explained in detail in the subsequent judgment by the Hon'ble Supreme Court in the case of **ADIT vs. E-fund IT Solution Inc. (2017) 86 taxmann.com 240.**

24. In so far as the allegation of the Department that employees of the assessee were carrying out the business of the assessee in India is also misplaced, because the expatriates which were present in NIPL office were working as employees of NIPL only and were engaged in the business of NIPL only, i.e., installation and marketing activities. He drew our attention to details of employees given at page 369(9) to 369(11) of the paper book Volume-III, which contains the details of expatriate employees which were present in India. He submitted that they were working completely under the control and supervision of NIPL. The designation of these

employees clearly point out they were technical personnel engaged in the activity of installation which was undertaken by NIPL as an independent contractor. Nowhere is it borne out from the record that any of the employees of the NIPL were involved in any manner in the matter of either negotiating the supply contract or sale of off-shore equipments. The clarification regarding Hannu Karavitra had already been given by him in detail and reiterated that nowhere after he became the employee of NIPL; he had assisted or carried out any function for the assessee *qua* negotiation of contracts, networking or supply of equipments.

25. Again with regard to the allegation made by the Assessing Officer that NIPL was undertaking marketing and after sale services on behalf of the assessee, Mr. Deepak Chopra submitted that the said services were performed by NIPL under a separate and independent contract which was under a 'Service Agreement' signed between the assessee and NIPL on 19.04.1996 and 6.11.1997. He drew our attention to page 137 of the paper book Volume-II and pointed out that the service agreement makes it clear that NIPL was being separately remunerated for such services at cost plus 5% mark up and same was offered to tax in India. Though the Assessing Officer and ld. CIT (A) have held that such a remuneration was on lower side but no material fact has been brought on record that either it is below the market rate or there was any transfer pricing reference for bench marking such a transaction. Once remuneration is at arm's length

then such an allegation are baseless *qua* PE. Hence, this allegation of the Department does not hold any ground. Lastly, he submitted that the onus lies heavily upon the Revenue to show that how the Indian company is a fixed place PE for the assessee and nowhere it has been brought on record or conclusively proven that either there was any fixed place of business in the form of NIPL; or any such space was made available to the assessee which could be said to be at the disposal of the assessee. Again he reiterated the principle laid down by the Hon'ble Supreme Court in the case of Formula One World Championship Ltd. case and E-Fund IT Solution and concluded by stating that, when NIPL does not satisfy the test laid down by the Hon'ble Supreme Court for the 'fixed place PE', then it cannot be held that there is any fixed place PE in terms of Article 5(1) of the assessee in India in form of its subsidiary, NIPL.

26. Coming to the issue of attribution of profits to such PE, Mr. Chopra submitted that, if at all it is held that NIPL constitutes a PE in India for the activities of signing, network planning and negotiation of contract, then at the outset it needs to be seen, whether the income arising to assessee from off-shore supply of equipment is taxable under the Act or not; and only if it is taxable under the Act, then only there would arise question about its taxability under the DTAA as DTAA does not contain any charging provision. The articles of the DTAA are only relevant for the allocation of taxing rights in an international transaction. He submitted in terms of section 9,

nothing has arisen or accrued or deemed to have accrued in India qua off-shore supply. He again reiterated the judgments as referred to by him in earlier part of his submissions. He further submitted that, on examination of Article 7, it is clear that business profits of assessee can only be taxed in India if the assessee has a permanent establishment in India and that too only to the extent that such profits arise out of the activities performed by such PE in India. In the present case when assessee does not have a PE in India, then the basic test for attributing business income remains unsatisfied in the instant case. The activities that are now alleged to have been carried out by Nokia India are the same as in the case of the LO which have been held to be preparatory by the Hon'ble Court. Even if it is assumed that the income arising from off-shore supply of equipment, wherein transfer of title took place outside India, is taxable under the Income tax Act and the Indian subsidiary is held to be a Permanent Establishment of the assessee in India, then also no profit can be attributed to PE in India as no activities pertaining to off-shore supply were performed in India. He again placed reliance on the order of the Hon'ble High Court wherein while remanding the matter back to this Tribunal it has been specifically directed that this Tribunal needs to analyse the attribution of income only *qua* the following activities namely:- a) Signing; b) Network planning; and c) negotiation of off-shore supply contracts in India. On these activities he submitted that no income per se has accrued to assessee and these are only preparatory

activities. Strong reliance was also placed on to the judgment of the Hon'ble Jurisdictional High Court in case of **Ericsson A.B., 343 ITR 470 (Delhi HC),** wherein it has been held as follows:-

> *"20. The aforesaid analysis will bring forth, the legal position that the places 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 only then would question of apportionment arise having regard to the expressed language of Section 9(1).*

Relying upon the aforesaid proposition, it was contented before us that *firstly*, the ratio is squarely applicable in case of the assessee and *secondly*, in the light of limited scope of remand as directed by the Hon'ble High Court, it is evident that determination of existence or otherwise of permanent establishment is a mere academic exercise as even if it is held to be so there cannot be any attribution for the activities which have allegedly been carried out by the Indian subsidiary in India.

27. Lastly, without prejudice to the aforesaid contentions, Mr Chopra submitted that assessee did not earn any profits from its Indian operations, *albeit* suffered heavy losses as in the relevant assessment years, the Indian Telecom industry was going through a bad phase and to enter a competitive market place like India, assessee had to write-off significant debts with respect to its equipment supply. In support of this contention, he drew our attention to India specific financials appearing at Page 151 (of the Paper book Vol.-II). The financials for India Tax purposes appearing in said page which has been stated to be verified and certified by the auditors is reproduced hereunder:-

P & L for Indian Tax purposes of Nokia Networks OY Equipment Sales to India;

	1.4.96-31.3.97	*1.4.97-31.3.98*
	USD	*USD*
Sales	*15,751,391*	*14780144*
Direct Costs	*21024054*	*10525700*
R&D costs	*8363925*	*2704028*
A&G costs	*616910*	*307170*
Sales and Marketing costs	*9249171*	*9857918*
BOA advisory financial expenses - 250000		
Net Profit	***(-) 23752669***	***(-) 8614672***

The profit and loss account for the period April 1, 1996- March 31, 1997 and April 1, 1997 – March 31, 1998 based on the cash method of accounting give a true and fair view of the profitability of the Indian business of Nokia Networks OY (formerly Nokia Telecommunications OY).

May 29, 2000

From the said financials it was strongly contended before us that the assessee suffered significant losses in the impugned years with a loss of USD 23,752,669 for financial year 1996-97 and a loss of USD 8,614,672 for financial year 97-98. Thus, when the assessee itself has suffered losses with respect to the transaction of off-shore supply, then there remains no question of attributing profits to any activities alleged to be carried out in India.

28. On the issue of taxability of notional interest on delayed consideration of supply of equipment and licensing of software, Mr. Deepak Chopra submitted that in the assessment order, the AO has made this addition on the assumption that assessee provided credit facilities to its customers and has charged interest on the same. To come to this conclusion AO had relied upon Para 6.9 of the contract between assessee and Modi Telstra to conclude that purchaser were liable to pay interest @ 18% for each day elapsed from the due-date to the actual payment. Hence, the sole ground for making the addition was the existence of this condition in the agreement signed between assessee and some of the Indian Cellular Operators. In appeal before CIT(A), the assessee submitted a certificate (copy appearing at Page 186 of Paper book- Vol II) which clearly states that assessee did not invoice any of its customers during the period 01.04.1996 - 31.03.1998 for any interest for late payment, nor received any such interest. Hence, the said clause was never invoked by the Assessee on any of its

customers. The assessee further submitted before the CIT (A) that there was no possibility of recovery of delayed payment and thus, when the recovery of principal itself was doubtful then there was no question of charging or earning interest on the same. The Ld. CIT(A) rejected assessee's submission and held that the fact that it was entitled to receive such interest proves that such interest had actually accrued to the assessee on delay committed by the Purchaser. CIT(A) had also rejected assessee's books of accounts on the ground that being a company it was bound to follow mercantile system of accounting and since was not followed, then its books of accounts cannot be relied upon. Thus, relying on the order of Supreme Court in State Bank of Travancore [1986] 158 ITR 102 (SC), the CIT (A) had confirmed the addition made by the AO. Mr. Chopra submitted that the conclusion drawn by the Ld. CIT (A) is based on incorrect interpretation of the order of Hon'ble Apex Court. In the case of State Bank of Travancore the interest in issue was the interest accruing on sticky advances, i.e., advances considered doubtful of recovery and the account of parties were debited with such interest. In that context the court went on to hold as under:-

> *"In other words simply because the assessee has been regularly employing the mercantile system of accounting it would not mean that any hypothetical income which may have theoretically accrued but has not truly resulted to him in the concerned accounting year can be brought to charge and, therefore, the question whether the three sums representing interest on sticky loans had really accrued to the assessee or*

not would be a matter of substance and cannot be determined by merely having regard to the method of accounting (here mercantile system) adopted by the assessee. Secondly, it will have to be borne in mind that this is not a case where the assessee had ignored or failed to make any entries at all in regard to such interest on advances or loans which had become sticky in its books maintained or mercantile system but it had charged such interest by debiting the accounts of concerned debtors and had designedly credited it to 'Interest suspense account' instead of carrying it to 'Profit and loss account' with a view to avoid showing unreal or inflated profits. A 'suspense account' in book-keeping means an account in which items are temporarily carried pending their final disposition; it does not appear in financial statements' vide Kohler's Dictionary for Accountants, Third edn. Since the final disposition of the sums in question was uncertain and hung in balance these items were properly carried to 'Interest suspense account' and could not and did not find a place in the financial statement like the profit and loss account. From the mere fact that such interest was charged to the concerned debtors by making debit entries in their respective accounts no inference could be drawn that the assessee had regarded it as accrued income because simultaneously such interest was credited to interest suspense account and not to profit and loss account. The taxing authorities, the Tribunal and the High Court clearly erred in drawing such inference against the assessee. In fact by making the aforesaid entries and treating the three sums in the manner done the assessee must be regarded as having demonstrably shown an intention to treat such interest as its hypothetical and not real income. ”

Thus, he pointed out that the facts in the case of state bank of Travancore were different than those in the present case to the extent that in the former, the assessee had himself debited the interest to the account of the parties and after that same was carried to suspense account while in the present case the assessee had not even raised invoices for such interest. In such a scenario it cannot be said that interest on delayed payment accrued to the assessee. He also placed reliance on the order of Hon'ble Supreme Court in case of **UCO bank vs. CIT [1999] 237 ITR 889 (SC)]** wherein the Hon'ble Apex Court had distinguished its order in case of State Bank of Travancore on the ground that the said judgement failed to consider the subsequent circular issued by CBDT which provided that “"interest in respect of doubtful debts credited to suspense account by the banking companies will be subjected to tax but interest charged in an account where there has been no recovery for three consecutive accounting years will not be subjected to tax in the fourth year and onwards. However, if there is any recovery in the fourth year or later the actual amount recovered only will be subjected to tax in the respective years. This procedure will apply to assessment year 1979-80 and onwards. The Board's Instruction No. 1186, dated 20-6-1978 is modified to this extent." In view of the said Circular, the issue was decided in favour of the assessee. Thus, from the above decision, it becomes clear that the SC order in State Bank of Travancore does not hold the field as far as notional interest is

concerned. He further placed reliance on the judgment of Hon'ble Supreme Court in the case of **CIT vs. Excel industries Ltd. [2013] 358 ITR 295 (SC)** and submitted that if the principle laid down in the said judgment is applied then in the present case even if it is accepted that assessee in fact was entitled to such interest, but then there was no corresponding liability on any of the debtors to the extent that assessee did not issue any invoices for such interest. In absence of such corresponding liability to pay, it cannot be said that any income had accrued to assessee on account of delayed payments. Ld. Counsel thus submitted that only 'real income' can be exigible to tax and notional income cannot be subjected to tax. As an alternative argument he had submitted that, even if it is held that certain income accrued to the assessee owing to the delayed payment received by it, then same shall be in the nature of business income and in absence of assessee having any Permanent Establishment in India, nothing can be brought to tax on this account.

Arguments on behalf of the Revenue:-

29. Ld. CIT-DR, Mr. T.M. Shiv Kumar arguing on behalf of the Revenue, after narrating entire facts as culled out from the impugned orders and the background of the case, submitted that the assessee company is not only engaged in manufacturing but is also selling GSM equipments and installing them in India for the Indian customers as a part of its overall business in India. Earlier the entire business was

done through LO which later on was continued with the subsidiary company, NIPL. Country Manager of LO continued to be the Managing Director of Indian company. There is a complete merger of identity of LO and NIPL which is also borne out from the fact that office of the LO and the office of the Indian company is the same and co-located and all the employees of the LO have been absorbed by the Indian company who now pay for their salary. Even the customers in India have treated the assessee and NIPL as one and the same. Thus, the entire identity got blurred and NIPL is practically a virtual projection of assessee in India. He submitted that Assessing Officer has extensively discussed the agreement between the NIPL and the assessee which is appearing at page 16 of the assessment order, wherein as per the contract the NIPL was not only providing marketing and consultancy services but as well as commercial and industrial information to assessee in the field of market development, liaisioning with customers, providing information and technical assistance to the customers in India and marketing of the products of assessee in India. This goes to show that NIPL was doing varieties of activities for the assessee in India. Drawing our attention to page 369(1) to 369(11) of paper book Volume III, he pointed out that employees of the assessee were seconded to NIPL by the assessee or were working in NIPL, which shows the assessee's presence in all the activities of NIPL. Not only that, most of the salary too was paid by the assessee and only the perquisites were given by the Indian

Company, which is evident from the fact that salaries paid was in foreign currency. These seconded employees were employed for installation contract of NIPL. Such an installation through employees of the assessee constitutes a PE in India. During the course of the assessment proceedings, Assessing Officer has specifically required the assessee to submit the employee wise details and who was performing which task, but same was not submitted by the assessee. Even the information of duration of expatriates was also not given. To prove his point he drew our attention to the Departmental paper book at pages 32, 35 and 36, and submitted that specific query by the Assessing Officer was raised to give the details, which assessee could not provide. If the entire gamut of facts and material are taken into consideration, then it could be easily deduced that assessee was having a fixed place business in India for all practical purposes. Again drawing our attention to page 56 of the paper book, he submitted that Mr. Hannu Karavitra had signed the balance sheet of the LO as a Country Manager as on 31st December, 1998. This goes to show that Mr. Hannu Karavitra was not only the Country Manager of LO but also the Managing Director of NIPL post incorporation of NIPL in the year 1995. Thus, when assessee's employee was working for the assessee and also for the subsidiary then the same employee constitutes a PE not only in the context of Service PE but also PE under Article 5(5) and 5(1). In support, of this contention he strongly relied upon the ratio in the judgment

of Hon'ble Supreme Court in the case of **DIT vs. Morgan Stanley & Co. Inc. (2007) 292 ITR 416** and Delhi High Court judgment in **Centrica India Offshore vs. CIT**, reported in **(2014) 364 ITR 336 (Del).**

30. The Installation Contracts immediately after the incorporation of Indian Company has also been signed by same person, Mr. Hannu Karavitra. Not only that, whenever the assessee's employee use to come, then the NIPL was providing infrastructure facilities like telephone, fax, vehicles, etc., to the assessee's employee by the Indian company. This fact itself goes to show that there was a place in the form of Indian company which was at the disposal of the assessee. In any case, initiation of the contract required very technical details which required expatriates and not only for the marketing but also for installation, which services has been provided by NIPL. Even it is proved that one sale of the assessee is through Indian company, then it will attract *"force of attraction rule"* under Article 7 of the India Finland DTAA. Thereafter, he referred to various clauses of the agreement entered into between the assessee and NIPL with regard to various kinds of responsibilities and obligations carried out by both the parties. He further referred to the statement of one, Mr. Simon Piers Beresford Wylie, MD of NIPL which AO had recorded during the course of assessment proceedings on 14.02.2000. Further drawing our attention to question nos. 8, 9 and 10, he pointed out that NIPL was carrying out the marketing activities for the assessee and also administrative

support like office staff, cars, telephones, etc. which were provided by the Indian company to the assessee. It was because of loading of such expenditure that the Indian company was having huge losses despite that arrangement between the assessee and Indian company was cost plus 5% mark up. Apart from that, one important fact he pointed out that as per the arrangement, the assessee was not to dilute the equity of share of 50% of NIPL which shows that the Indian company was totally depended upon the assessee. This not only goes to show the nature of dependency of NIPL upon assessee-company but also its control. He further submitted that, Assessing Officer in his order has categorically mentioned that before the contract was signed by the assessee and its customers in India expatriates of the assessee came to India, stayed in India and carried out the network planning. They were also involved in negotiating the terms with various customers and were interacting with them on regular basis, all these activities were done by the assessee using the premises of NIPL, which were at its disposal. These facts have been confirmed by the Managing Director of NIPL, Mr. Simon Piers Beresford Wylie in his statement recorded on oath on 14.02.2000 u/s.131, wherein he has affirmed that about the fact that employees of assessee were coming to India for contract negotiation and entire support mechanism were provided by the NIPL with administrative support like office, telephone, fax, conveyance, etc. This has been independently confirmed by the assessee in the memorandum

of minutes recorded by the assessee which is also part of the paper book wherein it has been explicitly written that *"This memorandum documents our meeting and discussions with Mr. SMJ Abidi, Deputy Commissioner of Income Tax, Non-Resident Circle, New Delhi ("DCIT") on February 14, 2000, in connection with the summons notice issued under section 131 of the Income Tax Act, 1961."* by Mr. Simon Piers Beresford Wylie, Managing Director of Nokia Limited

30. He also referred to the following questions and answers which have been incorporated in the assessment order:-

> *"Q. no.8- During 1995 and 1996, when most of the contracts were signed, how was marketing carried out by the Indian company?*
>
> *Ans. The DCIT was informed that the contracts entered into between Nokia Finland and Indian customers during 1995 and 1996 were complex infrastructure projects The DCIT was informed that the contracts entered into between Nokia Finland and Indian customers during 1995 and 1996 were complex infrastructure projects that required services of specialized people.*

Thus, Nokia Finland therefore, utilized marketing services of specialized expatriates of NIPL, administrative support in the form of office space, telephone and faxes etc. which was provided to them by NIPL. It was clarified that these expatriates were not on the rolls of NIPL. In Ques. No. 10 of the above referred statement, Mr. Simon Piers Beresford Wylie was asked as to what were the facilities provided by NIPL to the expatriates coming in India for marketing and signing contracts on behalf of Nokia Finland. It was affirmed by him

that administrative support of office, cars, telephone was provided by NIPL to the expatriates of the assessee. The relevant extract of the statement is as under:-

> "**Q.10.** *What all facilities were provided by Nokia Ltd. to the expats coming for marketing and signing the cont. on behalf of Nokia Ltd. Finland?*
>
> *Ans. Administrative support like office support, cars, telephone etc. is provided by Nokia Limited.*

This statement is also corroborated by the memorandum of the meeting placed by the assessee in its paper book. Further, the office place of the assessee and the Indian subsidiary company were the same. This fact was recorded in the statement as question no. 15 and also confirmed by the assessee in its memorandum dated 15-02-2000 recording the minutes of the statement taken on oath. The same is for sake of ready reference is reproduced here:

> "Q *15. Are there separate offices of Nokia Finland Oy and Nokia Ltd. since 1995?*
>
> *Ans. Always the offices have been the same."*

The assessee has also confirmed the same in its memorandum of the minute's recorded in question No. 15 as under:-

> *Are there separate offices of Nokia Telecommunications Oy, India Liaison Office and Nokia Limited since 1995 or there is only one office? It was informed to the DCIT that Nokia Limited and Nokia Telecommunications Oy. India Liaison Office have the same office in India. They have however shifted the office during this period."*

Mr. Simon Piers Beresford Wylie was asked as to how the network planning was carried out in respect of the contracts and what the role of NIPL in that was. The relevant excerpt of the memorandum of meeting with regard to the same is as under:-

> *"Q. no. 9 (of the memorandum)- How was network planning carried out before the signing of contract? What is the role of Nokia Limited?*
>
> *Ans. It was informed to the DCIT that network planning is generally carried out by Nokia, depending upon customer specification."*
>
> "Q. *no. 10.* Do *you have people coming from abroad? Are they using support services of Nokia Limited?*
>
> *Ans. The DCIT was informed that some expatriates are involved in training the employees of Nokia Limited. Administrative support in the form of office space, telephone and faxes etc. is provided to them by Nokia Limited. It was again clarified that these expatriates are not on the rolls of Nokia Limited."*
>
> *"Q. no. 11. Were you paying any salary, reimbursements, perquisites etc, to employees of Nokia Finland who were here for short assignments?*
>
> *Ans. They informed the DCIT that Nokia Limited did not pay any salary, reimbursement or perquisite etc, to the employees of Nokia Finland who were here on short assignments."*

31. Thus, Ld. DR submitted that the aforesaid statement of the Managing Director corroborated by the memorandum dated 15.02.2000, clearly establishes the fact that assessee was carrying out negotiations, network planning and marketing of its business through the fixed place in the form of NIPL. The provision of office place, vehicles, telephone, etc.

also suggests that premise of NIPL was at the disposal of the assessee to carry out a part of its business in India. Taking part in contractual negotiation, carrying out network planning cannot be construed as preparatory or auxiliary activity. These activities performed through the fixed place provided by NIPL construed the core activity of the assessee and thereby create a PE of the assessee. He reiterated that the details regarding the name and duration of stay of the expatriates in India were asked repeatedly by the Assessing Officer from the assessee however despite reminders the assessee did not furnish these details and he again drew our attention to page no. 38 of the assessment order for Assessment Year 1998-99. He submitted that, if the overall gamut of the facts and evidences is to be analyzed it will go to show that assessee performed income generating activities of marketing, contract negotiations, network planning, etc., by NIPL which was at its disposal. There was a virtual projection of the assessee in India through NIPL which clearly establishes not only a business connection in India as well as establishment of PE in India in the form of its subsidiary NIPL. The NIPL being a subsidiary of assessee in India and consequently it has a position to control and monitor its activities. He also referred to certain paragraphs of earlier Tribunal order and drew our attention specifically to paragraphs number 273 and 274, wherein the Tribunal while holding NIPL to be PE has given certain observations. He also relied upon the decision of Hon'ble Supreme Court in the case of Formula One World

Championship (supra) and submitted that the 'disposal test' laid down by the Hon'ble Supreme Court is clearly established in this present case, because the assessee was having control over Indian company through its employee and the place of Indian subsidiary was also made available to the assessee. Once there is real and dominant control, then fixed placed PE gets established.

32. On the issue of NIPL as a DAPE, he submitted that NIPL did not acted as an independent contractor while dealing with assessee's customer and in fact NIPL was fully dependent on assessee not only of entering into contract with the assessee's customer but also for everything after it came into existence.

33. In so far as, on the issue of attribution of income, he submitted that the assessee has carried out operation in India, both pre and post negotiation, network planning through employees which as per the Department constitutes fixed place in India, therefore, the income of the assessee has to be attributed in terms of Article 7. The Assessing Officer had attributed fifty-fifty of the transaction by bifurcating the total project cost in the manner given in the assessment order. The ld. CIT (A) has taken the global net profit of 10% by taking 5% of total sales attributed in India, whereas the Special Bench of the Tribunal has taken 20% of the network and the profit which is to be attributed. So far as the contention of the learned counsel that huge losses have been

incurred by the Indian entity as well as Indian operation of the assessee, he submitted that, the same is not verifiable from the books of account, because details of sales were not provided to the Assessing Officer. Thus, such a contention could not be accepted what could be the proper attribution he relied upon following decision.

(i) Royals Royce Plc vs. DIT; ITA Nos. 495, 496, 497/2008 and other appeals (Delhi High Court)

(ii) Arrow Electronics India Ltd. vs. Addl. DIT, ITA. Nos. 209 & 210/ Bang/ 2001 (ITAT Bangalore Bench).

34. Lastly, coming to the issue of taxation of interest income from vendor financing and outstanding payments, Ld. CIT-DR submitted that assessee's claim that interest income was never received and it was a notional income which was added by the Assessing Officer cannot be accepted, because as per the agreement between the assessee and the customers the interest would accrue to the assessee and the contract provided that charging of interest on vendor financing and outstanding payment. The assessee company which is following mercantile system of accounting, therefore, the agreement in force during the year has to be taken into consideration and the contention of the assessee that the said clause was non operative cannot be accepted. Interest income was to be recognized on accrual basis and therefore, the Assessing Officer has rightly held that it is a part of the total income. Thus, he strongly relied upon the order of the Assessing Officer as well as the ld. CIT (A).

34.1 In sum and substance his arguments on PE can be summarized in the following manner:-

- Assessee's employees were stationed in India and provided services in India, which is evident that expatriates deputed were on payroll Nokia Ltd.
- Various expatriate employees visited India to provide services regarding supply of equipments, for which NIPL provided administrative support, like telephone, cars etc.
- Setting up of GSM network is very complex and technical project which was carried out by highly skilled employees of Assessee Company sent to India from time to time.
- Supply Contacts and related agreements were signed in India by the employees of assessee.
- The services claimed to have been provided by the NIPL both to the assessee and to cellular operators were in fact provided by expatriates of assessee and NIPL did not reimburse the salary. Details of expatriates and their salary paid in foreign currency were pointed out to before us.
- Responsibility and liability for all the services provided to the customers in India was with the assessee.
- Heavy reliance on the judgments of Morgan Stanley (SC) and Centrica (Delhi Hon'ble High Court) (supra).
- Identity of NIPL and assessee merged into one due to above factors and hence it acted as 'virtual projection' of foreign entity.

DECISION

35. We have heard the rival contentions and perused the relevant findings given in the impugned orders, materials referred to before us especially in the light of the direction given by the Hon'ble High Court and the scope of remand before this Tribunal. The Hon'ble High Court in respect of the following substantial question of law;

> *"1. Whether on a true and correct interpretation of the relevant DTAA the Tribunal's reasoning is right in law in holding that NIPL, (the subsidiary of the Appellant) is a permanent establishment?*
>
> *2. Whether the Tribunal was right in law in holding that a perception of virtual projection of the foreign enterprise in India results in a permanent establishment?*
>
> *3. Without prejudice, if the answers to Q.1 & Q.2 are in affirmative, is there any attribution of profits on account of signing, network planning and negotiation of offshore supply contracts in India and if yes, the extent and basis thereof?*
>
> *4. Whether in law the notional interest on delayed consideration for supply of equipment and licensing of software is taxable in the hands of assessee as interest from vendor financing?*

has remanded the matter to the Tribunal with certain observations. While adjudicating the aforesaid issues, the Hon'ble High Court had first of all noted certain errors which had crept in the earlier order of the Special Bench specifically

with regard to the certain facts which have been highlighted in the following manner:-

i. The Indian subsidiary was executing contracts on behalf of the appellant through its employees.

ii. All the contracts with the operators were signed in India.

iii. The employees of Indian Office (LO) were compensated by some other entity.

iv. From 1996 onwards all the expenses of Indian office were shifted to the Indian subsidiary.

v. The employees of the Indian office were responsible for execution of the contracts with operators.

vi. No compensation was paid to IC for marketing and support services prior to 1997.

vii. PSC was set up in India to supervise the supply contract with TATA.

viii. Certificate of acceptance was signed by Indian subsidiary on behalf of the appellant.

ix. The appellant has accepted that the license of customized software is not sale, but royalty, and

x. The appellant has actually earned interest from Vendor financing and on account of delayed payments by the operators in the relevant previous year.

36. After noting the aforesaid facts, Hon'ble High Court observed that the finding of fact by the Special Bench specifically with regard to point nos. i, iv, v and vi are purely based on assumption which are completely divorced from the

facts for arriving to the conclusion on NIPL being PE. The relevant paragraphs of the Hon'ble High Court have already been incorporated above but for the sake of ready reference same is again reproduced hereunder:-

"36. Mr. Parasaran, learned ASG appearing for the Revenue could not controvert the aforesaid pleas of Mr. Syali. We find that the aforesaid errors on facts have crept in. It is primarily for the reason that the Tribunal had taken the facts in the case of Ericsson case and on the presumption that those facts were common the case of Nokia as well and the legal questions in the appeals of Nokia were decided therefore the actual inaccuracy has crept in the fact findings of the Tribunal. We find justification in the argument of Mr. Syali that the clear cut impact of such assumptions is evident from the fact that findings (i), (iv), (v) and (vi) are all suppositions in the absence of appreciating that there was a marketing support agreement in operation from 1.1.1996 to the 31-12.1996. Even as per the AO after the later agreement of 1997 there is no allegation made as regards shifting of expenses, no compensation paid to Indian subsidiary, etc. in other words, once there was an agreement the issue only revolved on the nature of the agreement. Once it is accepted that the position in 1997 and 1996 is pari materia, there will not remain any such allegation.

37. We would like to record that the CIT (A) proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability. The CIT (A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian

subsidiary did not occur at arm's length. Mr. Syali argued that there was no basis for drawing such inference and at the time of arguments, the learned ASG conceded that there was no evidence to support that losses were absorbed by the Indian company. Again, pertinently, the Tribunal also observed that NIPL could be considered PE of assessee in India being subsidiary as it is the virtual projection of the company in India. Further, the accounts of the Indian subsidiary show that the "company incurred huge losses as it was not compensated properly for the installation work carried on by it. In the opinion of the ITAT since it was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary. The learned ASG also conceded that it was not correct.

38. As we find that the order of the Tribunal is based on many factual errors which are even accepted by the Revenue before us, it would be appropriate to refer the matter back to the Tribunal for fresh consideration on the issues as to whether the subsidiary of the assessee would provide business. connection or is Permanent Establishment and even if it is so, is there any attributes of profits on account of signing, under working, planning and negotiation of off-shore supply contracts in India. If yes, to what extent and basis thereof. Likewise, the question of notional interest on delayed consideration of supply of equipment and liaisioning of software taxable in the hands of assessee as interest from vendor financing would be considered afresh. The appeals of the assessee are thus disposed of with the aforesaid direction remitting the case rack to the Tribunal for fresh consideration on these issues."

37. From the findings and observation appearing from para 34 to 38 and the final directions given by the Hon'ble High Court, following aspect defining the scope of present proceedings can be as inferred:-

Firstly, there are only four contracts which are the subject matter of examination and the entire scope of adjudication of PE or attribution of profit which have been highlighted in paragraph 34 in the following manner:-

"34. We may recapitulate that there are four contracts which have been referred to in the orders of the authorities below. The same are:

(i) Supply contracts between the assessee and various customers.

(ii) Installation Contracts between the Indian subsidiary and the customers directly. Only two contracts with Modi Telstra and Skycell executed in February and March, 1995 were separate from the supply contracts and installation portion was assigned to the Indian subsidiary with the consent of all concerned.

(iii) Marketing support Agreements dated 19.4.1996 and 6.11.1997 between the assessee and its Indian subsidiary, and

(iv) Technical support agreement between Indian subsidiary and the customers.

Whereas the marketing support ensures to the benefit of the assessee the technical support ensures to the benefit of the Indian customer, the technical support is in respect of the projects installed and has nothing to do with the supply

contract. The consideration accruing or arising under the contracts already assessed in the hands of the Indian subsidiary and there is no adverse action in respect thereof. The technical support agreement referred to supra has not even been referred to by the authorities below in support of any of the allegations. Only general or loose reference has been made by the Tribunal. ***The dispute hence only pertains to the consideration under the Supply Agreement entered between the assessee and the various customers.***

Thus, the scope of dispute has been identified with reference to supply of equipment agreement between the assessee and the various buyers in India.

- *Secondly*, the Hon'ble High Court has also observed that marketing support agreements ensures benefit of the assessee whereas the technical support ensures benefit of the Indian customers which is in respect of project installed and has nothing to do with the supply contract. Already the consideration accruing, arising under installation contract, marketing support agreement and technical support agreement have already been assessed in the hands of Indian subsidiary and there is no adverse action in respect thereof.

- *Thirdly*, there were various factual errors which has crept in the order of the lower authorities which has been highlighted by the Hon'ble High Court and the learned Additional Solicitor General appearing on behalf of the

Revenue had not controverted this fact that these error do have crept in. Most of such erroneous assumptions of facts have been highlighted by the Hon'ble High court that they are based on presumptions and suppositions.

- *Fourthly*, there was no basis for drawing inference that transaction between the assessee and the Indian subsidiary did not occur at arm's length and there is no evidence to support that the losses of the assessee have been absorbed by the Indian company.

- *Fifthly*, another important fact which has been observed by the Hon'ble High Court in paragraph 37 is that the Tribunal has considered NIPL to be PE of the assessee being subsidiary as it is the virtual projection of the company in India and further accounts of the Indian subsidiary show that the company had incurred huge losses and it was not compensated properly for the installation work carried out. It has been conceded by the learned ASG is not correct.

- *Lastly*, since there were many factual error which has been accepted by the Revenue also, therefore, the Hon'ble High court deemed appropriate to remand back the matter to the Tribunal for fresh consideration only with regard to the following issues:-

(a) Whether the subsidiary of the assessee would provide business connection; or whether same constitutes a permanent establishment of assessee in India.

(b) And if the answer to above question is in affirmative then, whether any attributes of profits on account of signing, network planning and negotiation of off-shore supply contracts in India could be attributed to such business connection/ permanent establishment.

(c) Whether notional interest on delayed consideration of supply of equipment and licensing of software taxable in the hands of assessee as interest from vendor financing.

38. Thus, the finding and conclusion of the Special Bench based on the inference drawn that NIPL is a PE of assessee has been set aside and now the scope and concept of PE has to be seen in light of the facts on record and the direction given by the Hon'ble High Court; and if at all there is any attribution of income from PE, then same is to be seen only with respect to:-

(i) Assigning of contracts;
(ii) Network planning (wrongly mentioned in the judgment as under working);
(iii) Negotiation of off-shore supply in India.

39. Under this backdrop we would like to briefly recapitulate the relevant facts and the contentions raised by the party. The assessee company, Nokia Networks Oy has been incorporated in Finland and it is tax resident of Finland. At that point of time, it was a leading manufacturer of advance telecommunications systems and equipments (GSM Equipment) which were used in fixed and mobile phone

networks. These GSM equipments manufactured by the assessee were sold to the Indian telecom operators from outside India on principal to principal basis under independent buyer-seller arrangements. These facts have been noted by the Hon'ble High Court also in paragraph 2 of its judgment and are also borne out from the order of the authorities below. Apart from supply of the equipments there were also installation contracts and for this purpose of installation activity and other connected activities, assessee had established a Liaison Office on 30th March, 1994. Two such agreements were signed between the assessee (through LO) and Indian Cellular Operators viz., Modi Telstra India Ltd. on 30.03.1995 and Skycell Communication Ltd. on 17.02.1995. These contracts were signed by the assessee during the period when there was a LO of the assessee in India. Later on a wholly own subsidiary in the name of Nokia India Pvt. Ltd. was incorporated on 23.05.1995. After the incorporation of NIPL, all the contracts for installation were either assigned or separately entered by the NIPL with the customers. Marketing Support Agreement was also entered in the year 1996 and 1997 between the assessee and NIPL for providing marketing services to assessee for whom NIPL was compensated with cost plus markup. Technical support agreement had also been entered by the NIPL with the Indian customers in respect of projects installed again on principal to principal basis. However, the off-shore supply contract of GSM equipments between the assessee and Indian customers

continued to be done by the assessee. In the light of the facts and background discussed in detail in the foregoing paragraphs, we shall endeavor to examine whether the assessee company has any kind of business connection or permanent establishment in India either in terms of Section 9(1) of Income Tax Act; and/ or under Article 5 of then India-Finland DTAA.

40. Though the issue of business connection under the provisions of Income Tax Act should ordinarily be taken first as to whether any income of the assessee directly or indirectly accrues or arises through or from any business connection in India. But, since the main mandate of the direction of the Hon'ble High Court as well as the key arguments of the parties before us including the case of the department mostly revolves around the question whether assessee had any permanent establishment in the form of NIPL in terms of Article 5 or not, therefore, we will take up the issue of PE first. Before we examine the relevant facts and material on record for the purpose of examining whether the assessee has a PE or not, it would be relevant to incorporate the provisions of Article 5 (which stood at the relevant time) of India-Finland DTAA, the same read as under:-

> *"1. For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carries 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, a quarry or any other place of extraction of natural resources ;

(g) a warehouse ; and

(h) premises used as a sales outlet or for receiving or soliciting orders.

(3) *The term 'permanent establishment', also includes -*

(a) a building site, a construction, assembly or installation project or supervisory activity in connection therewith, but only where such site, project or activities continue for a period of more than six months ;

(b) a building site, a construction, assembly or installation project or supervisory activity being incidental to the sale of machinery or equipment, where such site project or activity continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery or equipment.

(4) *Notwithstanding the preceding provisions of this Article, the term 'permanent establishment' shall be deemed not to include -*

(a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise ;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpo.se 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 advertising, for the supply of information or for scientific research, being activities, solely of a preparatory or auxiliary character in the business of the enterprise.

(5) Notwithstanding the provisions of paragraphs (1) and (2), where a person - other than an agent of an independent status to whom paragraph (7) applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph (4) which, if exercised through a fixed place of business, would not make the fixed place of business a permanent establishment under the provisions of that paragraph ; or

(b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

(6) *Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to reinsurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than agent of an independent status to whom paragraph (7) applies.*

(7) *An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he shall not be considered an agent of an independent status within the meaning of this paragraph.*

(8) *The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company or a permanent establishment of the other."*

Ergo, the above article provides:

- Para1 of the Article defines the permanent establishment ***as a fixed place of business through which the business of an enterprise is wholly or partly carried out;***
- Para 2 and 3 give instances and illustration of places

which are treated as PE;

- Para 4 provides exclusion of certain activities and the place which are specifically not deemed to be PE and once such exclusion which would be relevant for the purpose of our case is clause (e), which provides for ***maintenance of fixed place of business solely for the purpose of --------------,being activities, solely of a preparatory or auxiliary character in the business of the enterprise;***
- Para 5 further excludes certain kinds of agent of enterprise that if the business is carried out on through the agents then it is deemed to have a PE, if he undertakes any of the activities as described in clauses (a) and (b). Here the crucial term which has been emphasized is that he ***habitually exercises in that state an authority to conclude contracts*** in the name of the enterprise;
- Para 6 carves out specific activity of the agent with regard to the insurance business; and
- Paragraph 7 provides that an enterprise shall not be deemed to have a PE simply because it carries out the business through agent of an independent status if such an agent is acting in the ordinary course of business, except that if such an agent is devoted wholly or almost wholly on behalf of that enterprise, then it is not reckoned to be as an independent agent.

- Lastly, one very important exception which has been carved out in para 8 is that, if a company which is a resident of a contracting state of a foreign entity (here for instance NIPL) is controlled by company which is resident of other contracting state (Nokia Finland) or which carries on the business in that other state, i.e., India, (whether through a PE or otherwise) shall not of itself constitute either a company or the PE of the other. This *inter-alia* means that merely having a subsidiary company or if foreign enterprise has a control on that company which carries out the business in that country (India) will not itself construe a PE.

41. We shall now deal with the concept of *'fixed place of PE'* which has been harped upon by the ld. CIT-DR at great length and has been objected to by the learned counsel that it was never the case of the department either by the Assessing Officer or by the ld. CIT(A) that the assessee had a fixed place of business in terms of Article 5(1), *albeit* the entire case of the Revenue was that NIPL is a DAPE in terms of Article 5(5). Despite Ld. Counsel's objection we would like to proceed with the applicability of the 'fixed place PE' in the case of the assessee, because;

- *Firstly*, there is a reference by the Assessing Officer in paragraph 36 of its order though it was more in the context of LO. The relevant portion of paragraph 36 for the sake of ready reference is reproduced hereunder:-

"Before the contract was signed a number of expatriates came to

India, stayed in India and carried out the network planning. They were also involved in negotiating the same with various customers and were interacting with them on regular basis. This was not possible without the assessee having a fixed place of business from which it carried out these operations. This fixed place of business was the liaison office together with office of the Indian company. This fact has been confirmed by the Managing Director of the Indian company that the expats who were coming to India were provided administrative support like office, telephone, fax and at times conveyance."

- *Secondly*, even the Special Bench had proceeded to determine the issue of NIPL constituting a fixed place PE in India; and
- *Lastly*, even the ld. CIT (A) in the impugned order though in the context of LO had also mixed up the concept of fixed place PE in the case of NIPL.

Accordingly, we are proceeding with adjudication of the fixed place PE *qua* NIPL. In para (1) of Article 5, one of the crucial terms used is 'fixed place of business ***through*** which the business of an enterprise is wholly or partly carried on'. The word *'through'* assumes a great significance, because it enlarges the scope of a fixed place in as much as where no fixed premises may belong to an enterprise but even if a particular space is made available at its disposal then such place is reckoned to be place of business under this paragraph. Now it is well accepted principle that if an enterprise has a certain specified place at its disposal which is used for its business activities, then it is sufficient to

constitute a place of business even though such availability of space to an enterprise may not give it any legal right to use that place. The entire concept of fixed pace PE under Article 5(1) under the OCED model convention had come up for consideration before the Hon'ble Apex Court in the case of **Formula One World Championship Ltd. vs. CIT (supra)**. Their Lordships have threadbare discussed the concept after referring to various commentaries and views of eminent international jurists, judgments rendered by foreign courts and also the judgment of Hon'ble High Courts in India. The Hon'ble Apex Court first of all have referred to the judgment of the Hon'ble Andhra Pradesh High Court in the case of **CIT vs. Vishakhapatnam Port Trust reported in (1983) 144 ITR 146**, wherein the Hon'ble High Court had laid down a very important proposition which is reproduced hereunder:

> *"The words 'permanent establishment' postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country."*

Thereafter, their Lordships have referred to the commentary of Philip Baker on the concept of PE and in paragraph 27 of the order have observed that the principal test, in order to ascertain whether an establishment have a fixed place for business or not is that such a physically located premises

have to be 'at the disposal' of the enterprises. At the disposal of the enterprise means when the enterprise has the right to use the said place and the control thereupon. The relevant paras are reproduced hereunder:-

> *"28. The principal test, in order to ascertain as to whether an establishment has a fixed place of business or not, is that such physically located premises have to be 'at the disposal' of the enterprise. For this purpose, it is not necessary that the premises are owned or even rented by the enterprise. It will be sufficient if the premises are put at the disposal of the enterprise. However, merely giving access to such a place to the enterprise for the purpose of the project would not suffice. The place would be treated as 'at the disposal' of the enterprise when the enterprise has right to use the said place and has control thereupon.*
>
> *28. ....*
>
> *29. According to Philip Baker, the aforesaid illustration confirm that the fixed place of business need not be owned or leased by the foreign enterprise, provided that is at the disposal of the enterprise in the sense of having some right to use solely for the purpose of the project undertaken on behalf of the owner of the premises."*

Further, the commentary of Klaus Vogel has also been referred extensively by the Hon'ble Court and observed that the word '*through*' in the Article 5, emphasis is that the place of business will only qualify, only if the place is at the disposal of the enterprise. Referring from Klaus Vogel, the Hon'ble Court observed that the enterprise will not be to use

the place of business as an instrument for carrying out its business unless it controls the place of business to a considerable extent. Though hasten has been added that there are no absolute standard for the modalities and intensity of control. The disposal is the power to use the place of business directly. Further the Hon'ble Court is also referred to OECD commentary on Model Tax convention in the following manner:-

"33) OECD commentary on Model Tax Convention mentions that a general definition of the term 'PE' brings out its essential characteristics, i.e. a distinct "situs", a "fixed place of business". This definition, therefore, contains the following conditions:

- 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 means usually 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.

34) The term "place of business" is explained as covering any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. It is clarified that a place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it

simply has a certain amount of space at its disposal. Further, it is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A certain amount of space at the disposal of the enterprise which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is required. Thus, where an enterprise illegally occupies a certain location where it carries on its business that would also constitute a PE. Some of the examples where premises are treated at the disposal of the enterprise and, therefore, constitute PE are: a place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise. At the same time, it is also clarified that the mere presence of an enterprise at a particular location does not necessarily mean that the location is at the disposal of that enterprise.

35) The OECD commentary gives as many as four examples where location will not be treated at the disposal of the enterprise. These are:

(a) the first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business through which the business of that

enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

(b) Second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a "fixed place of business" (see paragraphs 6 to 6.3) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

(c) The third example is that of a road transportation enterprise which would use a delivery dock at a customer's warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place as being at its disposal so as to constitute a permanent establishment of that enterprise.

(d) Fourth example is that of a painter, who, for two years, spends three days a week in the large Page 45 office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a permanent

establishment of that painter.

36) It also states that the words 'through which' must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location which is at the disposal of the enterprise for that purpose. For this reason, an enterprise engaged in paving a road will be considered to be carrying on its business 'through' the location where this activity takes place."

42. After referring to aforesaid commentaries, the Hon'ble Apex Court analysed the relevant agreements and the facts and material on record in the case of Formula One World Championship Ltd. (supra) and considering the rival contentions has observed and held as under:-

66) As per Article 5 of the DTAA, the PE 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 PE, 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 PEs. Otherwise, sub-article (2) uses the word 'include' which means that not only the places specified therein are to be treated as PEs, the list of such PEs 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.

67) We are of the firm opinion, and it cannot be denied, that Buddh International Circuit is a fixed place. From this circuit different races, including the Grand Prix is conducted, which is undoubtedly an economic/business activity. The core question is as to whether this was put at the disposal of FOWC? Whether this was a fixed place of business of FOWC is the next question. We would like to start our discussion on a crucial parameter viz. the manner in which commercial rights, which are held by FOWC and its affiliates, have been exploited in the instant case. For this purpose entire arrangement between FOWC and its associates on the one hand and Jaypee on the other hand, is to be kept in mind. Various agreements cannot be looked into by isolating them from each other. Their wholesome reading would bring out the real transaction between the parties. Such an approach is essentially required to find out as to who is having real and dominant control over the Event, thereby providing an answer to the question as to whether Buddh International Circuit was at the disposal of FOWC and whether it carried out any business therefrom or not. There is an inalienable relevance of witnessing the wholesome arrangement in order to have complete picture of the relationship between FOWC and Jaypee. That would enable us to capture the real essence of FOWC's role.

xxx xxx xxx xxx xxx xxx xxx

76) We are of the opinion that the test laid down by the Andhra Pradesh High Court in Visakhapatnam Port Trust case fully stands satisfied. Not only the Buddh International Circuit is a fixed place where the commercial/economic activity of

conducting F-1 Championship was carried out, one could clearly discern that it was a virtual projection of the foreign enterprise, namely, Formula-1 (i.e. FOWC) on the soil of this country. It is already noted above that as per Philip Baker, a PE must have three characteristics: stability, productivity and dependence. All characteristics are present in this case. Fixed place of business in the form of physical location, i.e. Buddh International Circuit, was at the disposal of FOWC through which it conducted business. Aesthetics of law and taxation jurisprudence leave no doubt in our mind that taxable event has taken place in India and non-resident FOWC is liable to pay tax in India on the income it has earned on this soil."

43. The key sequitur and proposition which is culled out from the judgment of the Hon'ble Supreme Court is that;

- *firstly*, the fix place should be where the commercial and economic activity of the enterprise is carried out;
- *secondly,* such a fix place acts as a virtual projection of the foreign enterprise;
- *thirdly*, PE must have three characteristics, stability productivity and dependence; and
- *lastly*, fixed place of the business must be at the disposal of the foreign enterprise through which it conducts business.

Thus, according to the Supreme Court the *'disposal test'* is paramount which needs to be seen while analyzing fixed place PE under Article 5(1). Though in our humble understanding,

the test of permanency *qua* fixed place has been slightly diluted by the Hon'ble Court but not the "disposal test". Again this judgment of Hon'ble Supreme Court has been reiterated and referred extensively in a subsequent judgment by the Hon'ble Supreme Court in the case of **ADIT vs. E-Fund IT Solution (2017) 86 taxmann.com 240**, wherein the Hon'ble Apex Court had quoted extensively the same views and commentaries and also the judgment of Formula One World Championship Ltd. and held that there must exist a fixed place in India which is at disposal of foreign enterprise through which they carry on their own business. In that case, the Indian subsidiary company of the foreign enterprise was rendering support services which enabled the foreign enterprise in turn to render services to its client and the outsourcing of work to the Indian subsidiary was held to be not giving rise to fixed place of PE. This judgment of the Hon'ble Supreme Court nearly clinches the issue before hand in so far as role of Indian subsidiary while deciding the fix place PE.

44. Now in the light of the aforesaid principle we shall examine the various kinds of contracts/ activities undertaken by the assessee and the facts and material on record, specifically with reference to the following activities which have been identified by the Hon'ble High Court while remanding the matter back to the Tribunal.

(a) Signing of contracts;

(b) Network planning;

(c) Negotiation of off-shore contract in India.

As discussed earlier, the Assessing Officer has noted that LO was engaged in the activities of network planning, negotiation of contract and signing of contracts, however in the earlier round it has been categorically held that LO is not a PE *qua* these activities and nowhere there is a categorical and specific finding by the Assessing Officer or by the ld. CIT(A) in the entire order that there exist any fixed place PE *qua* the Indian subsidiary, i.e., NIPL, except for stating that office of the LO and NIPL were co-located, employees of the assessee were working with NIPL and therefore, it constituted a fixed place PE. If that reasoning alone is to be taken into consideration, then such an interpretation of PE did not found judicial favour either by the earlier Special Bench or by the Hon'ble High Court *qua* the LO, hence on same reasoning and principle, NIPL would also cannot be reckoned as fixed place PE. Be that as may be, one of the key arguments by the Revenue before us is that foreign expatriates were present in NIPL office who were working as an employee of NIPL and were engaged in the business of NIPL, i.e., installation and marketing activities. The key thrust of the ld. CIT-DR before us was that; *firstly*, Country Manager of LO continued to be the MD of the NIPL; *secondly*, the identity between LO and NIPL were blurred and NIPL was nothing but 'virtual projection' of the assessee in India; *thirdly*, NIPL was doing most of the activities in India like Market Development,

liaisioning with customers, technical assistance, marketing of products, etc.; *fourthly*, employees of the assessee company were seconded to NIPL for installation contract of NIPL, and their salaries were paid by the assessee, therefore, through these employees PE gets constituted and in support he strongly relied upon the judgment of Morgan Stanley and Centrica India off-shore Private Ltd. (supra); *lastly*, whenever the assessee's employee used to come to India then NIPL was providing infrastructure facilities like, telephone, fax, vehicles, etc. which goes to show that there was a place in the form of NIPL which was at the disposal of the assessee.

45. First of all, in so far as the allegation that the Country Manager of the LO continued to be the Managing Director of the Indian Company, the same has with reference to one employee, namely, Mr. Hannu Karavitra who was the Country Manager in LO and in that capacity has signed two contracts in the month of February and March, 1995. These contracts were signed when NIPL was not even in existence. After the incorporation of NIPL on 23.05.1995, not an iota of evidence has been brought on record that Mr. Hannu Karavitra had signed any contract on behalf of the assessee. He was a Managing Director of NIPL from 01.01.1996 to 31.07.1999 and after he was employed with NIPL, he has not signed any supply contracts with the Indian customers. All the installation contracts which have been signed by the NIPL have been executed by the NIPL independently with the Indian customers on principal to principal basis and any

income received or accrued thereof, was subject to tax in India. During the course of the hearing, it was brought to our notice that on one assignment letter dated 24.05.1995 was signed by Mr. Hannu Karavitra whereby on shore services were assigned to NIPL and while working in India he was receiving salary from assessee only. First of all, Mr. Hannu Karavitra was employed with the LO earlier, prior to the incorporation of NIPL and he was not employed with the Indian company. In any case assignment was from assessee to NIPL and no authority was being exercised on behalf of the assessee company vis-à-vis the customers. Whether Mr. Hannu Karavitra was representative of the assessee and was working for NIPL or was receiving salary from assessee, same would have some relevance in the context of 'Service PE', but certainly not while examining the 'fixed place PE'. Even if the arguments sake it is accepted that he was a seconded employee to NIPL, then also if he had worked under the control of NIPL despite lien was maintained with assessee company, then also it does not lead to an inference that assessee company was having any kind of a PE, leave alone under paragraph 1 of Article 5. Similarly the allegation has been made by the Assessing Officer as well as strongly contended by the learned CIT-DR that employees of the NIPL were mostly belonging to the assessee company as some of the expatriates/ technical persons were working on installation contract of NIPL for which activities, salaries were paid and managed by assessee. This concept perhaps may

assume some significance while deciding the concept 'Service PE' for which reliance was also placed by the learned CIT-DR on Morgan Stanley and Centrica off-shore Pvt. Ltd, however as per the then existing provision of Article 5 between India and Finland treaty, there was no such concept of 'Service PE' *per se* except for certain activities mentioned in clause (a) and (b) of Paragraph 3 of Article 5, which ostensibly are not applicable at all. Since none of the on-shore activities are carried out by the assessee in India *albeit* was done by its Indian subsidiary, provisions of paragraph 3 of Article 5 will also not attract. Once there is no concept of 'Service PE' (though there is no allegation by the Assessing Officer or CIT (A) that there is any kind of service PE), then such plea of the learned CIT-DR has no legs to stand. His core argument was on the point that installation activities done through employees of the assessee constitutes a 'Service PE' and assessee was unable to furnish the details of employees working in NIPL alongwith the details of their duration and therefore, in absence of such details adverse view should be drawn for treating these employees constituting PE in India. The entire thrust of his argument simply whittles down for the reason that *firstly*, there is absolutely no concept of 'Service PE' in the then existing provision of Article 5; and *secondly*, other than off-shore supply of equipment, no other activities has been carried out by the assessee after the incorporation of the Indian subsidiary NIPL and this fact has been accepted by the Hon'ble High Court also. Thus, any

activities relating to NIPL under the independent contract cannot be reckoned to constitute a PE in the context of Article 5(1); and even if for argument sake it is accepted that the activities of NIPL were managed by assessee, then also, it does not constitute PE *qua* activities of supply contract or any activity from where it can be held that any income has been received or accrued to the assessee in India or through or from any asset in India. NIPL is an independent entity and all its income from India operation is liable for tax in India.

46. Another set of allegations which can said to have some significance is that; whenever the employees of the assessee were visiting India in the context of networking, assigning or negotiation of off-shore supply contract, the employees of NIPL were either assisting by providing certain administrative support services made available in the form of telephone, fax and conveyance; or the NIPL was providing technical and marketing support services to assessee and hence it is assisting in sale of equipments of the assessee in India and therefore, NIPL *per-se* by *'force of attraction rule'* will constitute a PE, because even if one sale of the assessee is through Indian company then by virtue of this rule as enshrined in Article 7 of India-Finland DTAA, PE will get constituted and there would be a deemed PE in the form of Indian company whose income has to be attributed accordingly. This second part of allegation does not hold ground at all, because; *firstly*, as stated in the earlier part of the order, assessee and NIPL have entered into separate

marketing and technical support agreements in respect of the projects installed and has no correlation with the supply contract. This has been specifically held so by the Hon'ble High Court also in paragraph 34 reproduced in the earlier part of the order; *secondly*, not only that, for rendering these services NIPL was compensated with cost plus mark up of 5% which though has been adversely commented by the Assessing Officer and ld. CIT (A) but there has been no determination of ALP under transfer pricing mechanism. This *inter alia* means that the remuneration paid by the assessee to NIPL for these services has to be reckoned at arm's length; and *lastly*, not one off-shore sale has happened in India through NIPL and this fact has again been accepted by the Hon'ble High Court in its order that no part of off-shore supply was concluded in India with any business connection in India as it was independent contract between Assessee and Telecom operators in India. In so far as allegation of administrative support services provided to employees of assessee in India for supply contract by NIPL and hence it leads to fixed place PE, strong reliance has been placed by Ld. CIT-DR on the statement of the then Managing Director, Mr. Simon Bresford. From the relevant statement he had pointed out that how the marketing support services have been provided by the Indian company to the assessee and also the administrative support services were provided by NIPL to assessee. Regarding marketing support services by NIPL to assessee we have already discussed above that it was done

under separate contract and NIPL was remunerated at arm's length. In so far as administrative facilities being provided by the NIPL to the expatriates coming for signing of contract on behalf of the Nokia Finland, he had stated that, administrative support like office support, cars, telephones, etc. was being provided by NIPL; and earlier office of liaison office of NIPL are at the same premise in the year 1995. Relying on such statement, ld. CIT-DR has vehemently contended that this material facts itself goes to prove that there is a fixed place PE which was at the disposal of the assessee. In light of such contention, we have to see whether any place of business was provided by NIPL to the assessee which can be said to be at a disposal of the assessee for carrying out its business wholly or partly in India. The sequitur of the judgment of Hon'ble Apex Court as incorporated above is that, in order to ascertain as to whether an establishment being a fixed place for PE or not is that physically located premises have to be 'at the disposal of the enterprises'. Nowhere the disposal test has been diluted by the Hon'ble Apex Court rather it has been reiterated at various places not only in the Formula One World Championship judgment but also in the subsequent judgment of E-Fund. As culled out from the certain observations of the Assessing Officer as well as the statement of the MD that the employees of the assessee whenever came to India for the purpose of supply contract for negotiation on network planning, then they were provided administrative

services like telephone, fax and conveyance. Now, whether such kind of facilities can at all be treated to be a fixed place of business of the assessee company. Telephone or fax or a car cannot be reckoned as physically located premise. The word used in Article 5(1) is 'fixed place of business through which business of enterprise is wholly or partly carried out'. A fixed place alludes to some kind of a particular location, physically located premise or some place in physical form. Nowhere is it borne out that any kind of physically located premise or a particular location was made available to the assessee which was at the disposal of the assessee for carrying out wholly or partly its business through that place. Not only there should be an existence of a fixed place of business but also through that fixed place business of the enterprise should be wholly or partly carried out. No such material has been brought on record that any kind of such fixed place was made available. Providing telephone or fax or conveyance services can ever be equated with fixed place. Even the co-location of earlier LO office and the Indian subsidiary company was only in the initial year of 1995 and later on LO office has moved out which is also evident from the statement of the Managing Director. Thus, providing such kind of administrative support services to the assessee's employees visiting India will not form fixed place PE, and therefore, the great emphasis by the learned DR on this point is not much of credence as it lacks any further material support or evidence that any physical place was made

available which can be said to be at the disposal of the assessee for carrying out its off-shore supply contract in India. In fact the entire allegation of fixed place was *qua* the LO and never in the context of NIPL by the Assessing Officer. The entire case of the Assessing Officer was that NIPL is a DAPE of the assessee, because all employees of the assessee were either working for the NIPL or NIPL was undertaking certain marketing and technical support services for the assessee. The concept of DAPE would be discussed in succeeding paragraphs. However, so far as the issue of fixed place PE is concerned the same does not get established at all by making to reference of providing of telephone, fax and car facility to the employees of assessee visiting India. As regards allegation that expatriates employees of assessee in India were assisting the NIPL and hence used the office of NIPL, is of no relevance *qua* assessee's business, because, the technical expatriates were in India to assist/help NIPL with performance of installation activities of NIPL and not to carry out the business of the assessee which was manufacturing and sale of network equipments. This activity *per se* cannot be reckoned that the Indian office was being used for the purpose of assessee's business or assessee was undertaking business in India through fixed place of business. The test laid down by the Hon'ble Supreme Court does not get satisfied in this case as nothing has been brought on record by the AO or ld. CIT-DR that any physical space was made available which can be said to be at the disposal of assessee

for assessee's own business of supply and sale of equipments.

47. Now coming to the paragraphs 2, 3 and 4 of Article 5, it is not the case of any one that the NIPL constitutes any kind of PE under these provisions. *Albeit* if one goes by *clause* (*e*) of Paragraph 4 of Article 5, where it has been categorically provided that the PE shall not be deemed to include a maintenance of a fixed place of business solely either; a) for the purpose of advertising; b) for the supply of information or for scientific research; c) ***being activities solely of a preparatory or an auxiliary character in the business of the enterprise***. This clause clearly excludes any activities solely for preparatory or auxiliary in nature and if one goes by scope of remand by the Hon'ble High Court, i.e., to see, whether signing, networking planning and negotiation constitutes a PE and also whether profits can be attributed to such activities, then such kind of an activity ostensibly falls within the scope and realm of preparatory or auxiliary in nature, because mere signing, planning and negotiation or networking before supply of goods, are preliminary activities and therefore, under this all pervasive exclusion clause there cannot be any PE which can be deemed either in terms of Paragraph 1, 2 and 3 of Article 5. Under the present DTAA if activities are in the nature of preparatory and auxiliary character, then same have been specifically excluded from being treated as PE. Hence, even if for the argument's sake it is accepted that there can be some kind of fixed place under Article 5(1), then such a place cannot be reckoned as PE,

because the activities carried out from such a place are in the nature of preparatory and auxiliary. Accordingly, in terms of Article 5(4), there could not be any fixed place PE under Article 5(1) because the activities of the assessee in India were purely pertaining to network planning, negotiation and signing of contracts before off-shore supply of (GSM) equipments and sale of goods have been made off-shore outside India.

48, Coming to the Dependent Agent PE as provided in paragraph 5 of Article 5, the key consideration for holding an agent to be a deemed PE is that, a person/enterprise who is not an agent of independent status is acting in a contracting state (here in this case India) on behalf of an enterprise of other contracting state (here Finland) in respect of any activities where he habitually exercises an authority to conclude contracts on behalf of the enterprise; or if he has no such authority, but habitually maintains stock of goods or merchandise which he regularly delivers goods or merchandise on behalf of the enterprise, then he is deemed to be DAPE. From the material facts discussed in detail herein above are that the entire contract supply of off-shore equipments has been done by the assessee outside India and no activity relating to off-shore supply has been performed in India. There is no material fact on record that NIPL has negotiated or concluded any contract of supply of equipment on behalf of the assessee which binds the assessee. The title of the goods supplied is directly passed on to the customers

in India and NIPL neither undertakes any negotiation process nor assist in delivery of goods. Under a DAPE the character of the agent can be said to be determined; *firstly*, his commercial activities for the enterprise is subject to instruction or comprehensive control; and *secondly*, he does not bear the entrepreneurial risk. The agent must have sufficient authority to bind enterprise's participation in the business activities and the agent involves the enterprise to a particular extent in the business activities. Thus, the qualified character of the agency is the authorization to act on behalf of somebody else so much as to conclude the contracts. Here the NIPL neither has any authority to conclude contracts for supply nor any of the orders has been booked by NIPL which can be said to be binding upon the assessee. NIPL is an independent entity carrying out activities of installation, technical support services for the equipments installed are being carried out on principal to principal basis independently with Indian customers; and marketing support agreement is an independent agreement with the assessee for which it is remunerated at arm's length and none of its activities even remotely relate to supply of equipments, leave alone habitually exercising any authority to conclude contract. Lastly, it bears its own entrepreneurial risks.

49. We shall in brief examine various allegations of the AO, which has been harped upon by the Ld. CIT-DR also to contend that there is some kind of PE in the form of DAPE. First of all, Assessing Officer as discussed in the earlier part

of this order has time and again referred to the employment details of Mr. Hannu Karavitra which we have already clarified that he was the employee of the assessee as Country Manager in LO till the time NIPL was not incorporated and after the incorporation of NIPL, he became the Managing Director and his period and designation of employment is contained in page 369 (9 to 11) of the paper book, from where it is seen that he was Managing Director between 01.01.1996 to 31.07.1999. It has already been clarified that once the said employee came into rolls of NIPL, he has not signed any contract with any Indian customer for off-shore supplies but has signed installation contracts on behalf of the NIPL. All the details of supply contracts are contained at page 203 of the paper book which also gives the details of the persons signing it and none of the supply contract had been signed by any employee of NIPL. Thus, the basic condition contained in Article 5(5) does not stand satisfied at all. The contract which has been signed by NIPL is installation which cannot be reckoned DAPE, because assessee in India has not carried out any installation activities on its own. In so far as the allegation of the Assessing Officer that NIPL was in complete control of the assessee and was subject to its instruction. This again in our opinion is not a relevant consideration at all for a creation of a DAPE as discussed above, because none of the supply activities of the assessee has been carried out by NIPL and the employees if at all were for the NIPL's activities in India for which it is liable to tax in India. Further, for the

purpose of this clause also, if activities are of preparatory and auxiliary in nature, then again the same will not satisfy the threshold of DAPE. The Assessing Officer has also referred to the fact that in the accounts of LO for the period ending 31st December, 1995, there was an expenditure of Rs.5 crores which suddenly from the year 1996, got shifted in the Indian company and from there he draws an inference that Indian company has not received any compensation for the same from assessee and this shows the close business connection between the NIPL and the assessee. This observation again is of no consequence, because when the Indian company came into existence in May, 1995 operations of the LO were slowly scaled down and there was no was requirement of the LO and the employees of the LO were transferred to the Indian Company w.e.f. June 1995. In so far as the allegation of the Assessing Officer that NIPL is a dependent agent, we find that nowhere he has brought on record that NIPL had any authority to conclude contracts relating to supply of equipments on behalf of the assessee. The Managing Director in his statement in answer to question no.9 has clearly stated that network planning was a service which could be provided by NIPL; however he categorically emphasized that it is pre-bid exercise which was only exercised to request for quotation. Nowhere it has been said in the statement that NIPL in anyway had authority to conclude contract on behalf of the assessee. In so far as the other allegation of the Assessing Officer which has been discussed in the earlier part

that, NIPL has concluded contracts with cellular operators for installation services and it becomes responsibility of assessee to get the contracts executed by the NIPL; and further assessee had issued guarantee to the Indian customers that it will get the contracts executed by NIPL, again has no significance for determination of DAPE, because such a contention of the Assessing Officer may have been relevant for composite contract situation which is not the consideration in the present case and does not have any bearing whatsoever in this matter. Even otherwise also assisting in performance of the installation services of NIPL does not make Indian Company DAPE of assessee under Article 5(5); and revenues from installation is any way being taxed in India. Coming to another allegation that all the contracts were signed in India and employees of the Indian company have attended meeting at the time of finalization of such contracts as witnesses, is again of no consequence either for the purpose of fixed place PE or DAPE, because for the fixed place, disposal test needs to be satisfied; and for DAPE, authority to conclude contracts which is binding on the assessee needs to be seen. Next objection of AO is that the warranty and guarantee services provided by NIPL's employee were monitored by assessee and for the installation work done by Indian company, some kind of note regarding installation contracts were sent to the assessee. This objection has no relevance for determination of PE, because, *firstly*, it would have been of some relevance in the case of composite contract situation; and *secondly*,

managing or providing guarantee by assessee does not yield any income to the assessee, *albeit* to NIPL, which is taxed in India. Lastly, in so far as the expatriates of NIPL were responsible for installation work were employees of the assessee, only proves that assessee provided necessary assistance, information, knowledge and expertise to do the work. This observation of AO only goes to prove that that expatriates employees deputed in NIPL are in connection with the installation contracts executed by NIPL and since there is no concept of 'Service PE' in India, therefore, nothing turns around on such observation. Thus, on the facts and material on record, we hold that there is no DAPE within the scope and terms of Article 5(5) of the treaty.

50. Admittedly, paragraph 6 of Article 5 is not applicable. Paragraph 7 of Article 5 deals with 'agent of independent status.' Independence of an agent has to be both legal as well as economic independence. Legal independence has to be seen from the context, whether the agent's commercial activities for his principal are subject to detailed instructions or comprehensive control by the principal or not; or to what extent the agent exercises freedom in the conduct of his business on behalf of principal; or the agent's scope of authority is affected by limitations on the scale of business which may be conducted by the agent. Economic independence has to be seen from the context as to what extent the agent bears the 'entrepreneurial risk" or "business risk" and agent's activities are not integrated with those of the

principal; and whether the agent acts exclusively for the principal. The tests for determining the independent status has to be seen from what kind of activities is being carried out by the agent for his principal. Here in this case, first of all we have to borne in mind that installation activity carried out by NIPL is not generating any revenue or income for the assessee in India *albeit* any income from such activity is already subject to tax in India. The off-shore supply contract is carried out by assessee on FOB basis from Finland and as discussed in foregoing paragraphs NIPL is carrying out various onshore activities, like installation activity, marketing and technical support services, which fact has been clearly highlighted by the Hon'ble High Court in para 34, that these activities have nothing to do with supply contract. The consideration accruing or arising under the contracts undertaken by NIPL is already assessed in the hands of NIPL in India and there is no adverse inference in this respect. The dispute as highlighted by the Hon'ble High Court only pertains to the consideration under the Supply Agreement entered between the assessee and the various customers. Qua the supply contract nothing is being performed by the NIPL in India as agent of the assessee. None of the onshore activities of NIPL can be said to be devoted wholly and almost wholly on behalf of the assessee, because, the contracts undertaken and signed by NIPL in India are independent and on principal to principal basis with the Indian customers and assessee has not signed any kind of installation contract with the Indian

customers for which it could be said that the installation activity of NIPL was wholly and almost wholly on behalf of the assessee. The two contracts which were signed earlier prior to the incorporation of NIPL were separate and assigned to it and income from such installation has been shown in the hands of NIPL in India. There is no income whatsoever from installation activities has been earned by the assessee in India or can be attributed either directly or indirectly through NIPL. Insofar as other activities like marketing and technical support services are concerned, same has been transacted at arm's length as discussed in detail in foregoing paras, hence no profit can be attributed from these activities as held by the Hon'ble High Court. Even if NIPL is held to be; subject to significant control with respect to the manner in which work is to be carried out; is subject to detail instructions from the assessee as to the conduct of work; is exercising less freedom in the conduct of business on behalf of assessee; seeking approval from the assessee for the manner in which the business is to be conducted; etc., then all such control if at all could be only in relation to the contracts carried out by the NIPL in India to ensure technical quality of the contact work done. When there is absolutely no income generated to the assessee from installation contract work done in India by the NIPL, then all such comprehensive control does not have much relevance. Article 5(7) will apply only when some of the activities of the foreign enterprise are done by an agent wholly or almost wholly on behalf of that enterprise. Here the crucial

test is that activities of the assessee must be carried out through the agent wholly and almost wholly for the assessee. When installation activity is not carried out by the assessee in India and is done by NIPL on principal to principal basis with the customers then there is no question of examining the installation activity for purpose of PE. The activity carried out by the assessee through an agent in India would be key factor for examining PE. Thus, provision of paragraph 7 of Article 5 will also not apply.

51. Lastly, coming to paragraph 8 of Article 5, it clearly states that mere fact that company which is a resident of a contracting status controls or is controlled by a company which is resident of the other contracting states or which carries on the business in other state, whether through a PE or otherwise shall not of itself constitutes either company or a PE of other. This *inter alia* means that if the NIPL, i.e., an Indian company is controlled by assessee who is resident of Finland, then this by itself will not constitute a PE. Thus, a subsidiary cannot be reckoned to constitute PE merely because it is controlled by a foreign enterprise. In other words simply because NIPL is a subsidiary and is controlled by assessee it will not be treated as a PE. Even the OECD and UN Model Conventions clarify that mere existence of foreign enterprise's subsidiary in a source state should not give rise to foreign enterprise's PE in the source state. The reason being that the existence of a subsidiary does not by itself, constitute that subsidiary company is a PE of its Parent

entity, on the principle that, for the purpose of taxation, a subsidiary company constitutes an independent legal entity in the source state. This has been held so by the Hon'ble Apex Court in the case E-Fund IT Solutions. Thus, the exception given in Article 5(8) to a company controlled by a foreign enterprise or its subsidiary answers most of the allegation made by the Department that NIPL being a subsidiary of the assessee itself will provide status of a PE.

52. In so far as the argument of the learned CIT DR that Indian subsidiary is a virtual projection of the assessee as employees of Assessee Company were practically performing all kinds of work, and therefore, it has to be treated as a permanent establishment of assessee. In support of such a concept of virtual projection, strong reliance has been placed on the judgment of the Hon'ble Andhra Pradesh High Court in the case of CIT vs. Vishakapatnam Port Trust (supra) which the learned CIT DR submitted that have been referred and relied upon by the Hon'ble Supreme Court in the case of Formula One (supra) also. First of all, the concept of 'virtual projection' has to be seen in the context of any of the ingredient of PE enshrined in Article 5. Hon'ble Andhra Pradesh High Court while explaining the concept of fixed place PE, observed that the PE postulates existence of a substantial element of enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. Such a fixed place should be of such a nature that it would amount to a virtual

projection of the foreign enterprise of one country to the soil of another country. The concept of 'virtual projection' flows from the fixed place itself or with any other parameters of establishment of PE under Article 5. This concept alone is not relevant but has to be seen in relation to fixed place or any other concept of PE. The Hon'ble Supreme Court while coming to the conclusion in paragraph 76, held that not only Buddh International Circuit was a fixed place where the commercial or economic activity of conducting Formula One Championship was carried out, but one could clearly discern that it was a virtual projection of a foreign enterprise, namely, Formula One on the soil of this country. All the characteristic of the fixed place PE including the physical location and disposal test stood satisfied. The concept of virtual projection cannot be in vacuum *dehors* any other parameters of PE. In other words, virtual projection is in relation to either fixed place or in relation to any other parameters or conditions envisaged in Article 5. As in the case of Vishakapatnam Port Trust, it was in relation to fixed place. The concept of virtual projection does not mean that even without a fixed place, virtual projection itself will lead to an inference of a PE. If on a facts there is no establishment of a fixed place and disposal test is not satisfied, then virtual projection itself cannot be held to be a factor for creation of a PE. Thus, the concept of virtual projection brought in by the AO will not lead to any kind of establishment of PE. In so far as allegation of the department that employees of assessee were responsible for

all the activities, it has been already dealt by us that if at all it may have some bearing or relevance when examining Service PE, which was absent in the then prevalent DTAA. Thus, we hold that there is no PE within the terms of Article 5 of India Finland DTAA.

53. Now we shall deal with issue of whether assessee had any kind of a business connection in India in the form of NIPL. Though this issue has become slightly academic in view of our above finding, because even if it is held that assessee had a business connection in India, then also under the treaty provisions, if there is no PE in terms of Article 5, then no income can be attributed to India under Article 7. The Hon'ble High Court while remanding the matter back to the Tribunal in terms of paragraph 38 has also directed to examine as to whether the subsidiary of the assessee would provide business connection or is Permanent Establishment. Thus, for the sake of completeness, we shall discuss in brief, whether the assessee was having any kind of business connection in India or not. The provision of Section 5 of the Income Tax Act defines the scope of total income and sub section (2) reads as under:-

> *"(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—*
>
> *(a) is received or is deemed to be received in India in such year by or on behalf of such person; or*
>
> *(b) accrues or arises or is deemed to accrue or arise to him*

in India during such year. "

First requirement is whether any income is deemed to have been received in India to non-resident. Here on the facts of the case this clause may not be applicable, because undisputedly the title of the goods of the GSM equipments supplied by the assessee has been transferred outside India and the payments have also been received by the assessee outside India. *Secondly*, coming to the provisions of sub-section 2(b) which deals with accrual of income or deemed accrual of income, the provision of Section 9 has to be seen as it stood at the relevant time which read as under:

"Income deemed to accrue or arise in India.

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.*

Explanation.— For the purposes of this clause—

(a) in the case of a 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;

(b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the

purpose of export;

(c) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India

(d) in the case of a non-resident, being—

(1) an individual who is not a citizen of India ; or

(2) a firm which does not have any partner who is a citizen of India or who is resident in India; or

(3) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India."

The provisions of section 9(l)(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. 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.

54. Before us, regarding the existence of business connection, Mr. Deepak Chopra relied upon the judgment of Hon'ble Supreme Court in the case of **CIT vs. R. D. Aggarwal and Co. and Another, reported in (1965) 56 ITR 20 (SC)** and submitted that mere performance of some activities in the Indian Territory does not afford a business connection of foreign company in India. What is important to examine here is that the trading activities within the territories should be linked with the trading activities carried on outside the taxable territories. Here, in this case, he submitted that the activity in question is the off-shore supply of equipment for which relevant trading activities are procuring of raw materials, manufacture of finished goods, sale and delivery of goods, which all have been carried out outside India. Only the marketing activities which have been performed by the Indian Company is somehow relevant, but for that there is a separate agreement between the assessee and NIPL and already income arising there from to the Indian company has been offered to tax in the hands of NIPL. The activities performed by NIPL only led to making of offers by the customers in the taxable territories to purchase goods manufactured by the non-resident which latter was not

obliged to accept. Thus, in view of the principle laid down by the Hon'ble Supreme Court in the case of R.D. Agarwal and Co. (supra) he submitted that no business connection can be said to exist in the present case. The concept of agency as envisaged in the scope of business connection u/s.9(1)(i) of the Act was introduced by the Finance Act, 2003 and hence would not be applicable to the assessment years under consideration. Without prejudice, he submitted that how much portion of the profits whatsoever from the off-shores supply can be taxed in India is moot point. Regarding the agreements for contracts of supply of goods sold to the customers on CIP/FCA basis, he submitted that Hon'ble High Court in assessee's own case had given a very categorical finding that taxable event, i.e., transfer of title took place outside India, in support paragraph 17 of the judgment was relied upon which is quite relevant hence for the sake of ready reference is reproduced hereunder:-

> *"17. We find that the terms of contract make it clear that acceptance test is not a material event for passing the title and risk in the equipment supplied. It is because of the reason that even if such test found out that the system did not conform to the contractual parameters, as per article 21.1 of the supply contract, the only consequence would be that the Cellular Operator would be entitled to call upon the assessee to cure defect by repairing or replacing the defective part. If there was delay caused due to the acceptance test not being complied with, Article 19 of the Supply Contract provided for damages. Thus, the taxable event took place outside India with the*

> *passing of the property from seller to buyer and acceptance was not determinative of this factor. 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...........”*

Finally, he strongly relied upon the judgment of Hon'ble Delhi High Court in the case of **Nortel Networks India International Inc. vs. DIT, (2016) 386 ITR 353 (Del)** and submitted that this judgment squarely clinches the issue in favour of the assessee and strongly relied upon paragraph 43 to 47 of the said judgment. Relying upon the aforesaid judgment, he submitted that mere existence of a business connection it is not enough to trigger taxability in India in respect of off-shore supply of telecomm equipment to Indian customers because there must be same activity carried out in India relating to the off-shore supply.

55. On the other hand, learned CIT-DR has reiterated the same set of arguments that right from negotiation of contract to supply was undertaken through employees of the assessee either independently or through NIPL and the entire marketing activities for such sale has been done through NIPL. Hence, it constitutes a business connection in India.

56. We have heard the rival contentions made by the parties and also material placed on record. First of all, we find that the Hon'ble High Court in the context of LO has held that there is no material or evidence on the basis of which it can

be said that LO can offer a business connection to assessee in India and it does not constitute PE of the assessee in India. The same reason ostensibly applies to NIPL also, as the terms and conditions of supply contract continues as spelled out in para 17 of the judgment remains the same. Further, the Hon'ble High Court in paragraph 13 has noted that income which has been earned by the assessee is a result of supply of software and hardware license under the supply agreement and if supply agreement is taken on standalone basis then such supplies under this agreement were made outside India. The properties and goods has passed on to the buyers under the supply contract outside India where the equipment was manufactured and for coming to this conclusion, the Hon'ble High Court has referred and relied upon the judgment of Hon'ble Supreme Court in the case of **Ishikawajima Harima Heavy Industries Ltd. v/s. DIT,** reported in **(2007) 3 SCC 481**, that such agreement would not be taxable in India and no profit arising from supply of equipment outside India would be chargeable to tax in India. The Hon'ble Court has even drawn the parallels from the ratio of the said judgment of the Hon'ble Supreme Court in the following manner:-

> *"(i) In both the cases the property in the equipment passed outside India and in the case even the risk passed outside India;*
>
> *(ii) the case Ishikawajima's even though it was to perform onshore services including the erection and commissioning of the equipment supplied by it, nevertheless, the Supreme Court*

held that no part of the profit on the offshore supply of the equipment was taxable in India as a consequence of the performance of such activities in India. In the assessee's case the assessee does not perform any service in India in connection with the installation of the equipment or otherwise;

(iii) the performance of the acceptance test in India was not considered a relevant circumstance whilst determining whether any part of the profit on the offshore supply was chargeable to tax in India in the case of Ishikawajima, so also in the assessee's case.

(iv) although admittedly a permanent establishment existed in the case of Ishikawajima, nevertheless, the Court held that no part of the profit arising from the supply of the equipment was chargeable to tax in India as the permanent establishment had no role to play in the transaction sought to be taxed as it look place abroad, whilst in the case of the assessee, it has been found as a fact by both the appellate authorities that no permanent establishment existed;

(v) the mere signing of the contract pursuant to which the supply was made in India, in both cases does not result in giving rise to a tax liability in India;

(vi) the existence of the overall responsibility clause was held to be irrelevant in Ishikawajima's case and likewise the overall agreement executed in the assessee's case should not make any difference to the taxability of the equipment supplied;

(vii) giving the nomenclature of a turnkey project or works contract is not relevant in determining whether any profit

arising from the supply of equipment pursuant to such contract was chargeable to tax in India;

(viii) the Supreme Court relied upon Instruction No. 1829 to come to the conclusion that the existence of an overall responsibility clause was not material in determining the tax liability arising from the offshore supply of equipment and as the said instruction continues to be in force for the assessment year relevant to the present appeals, the existence of an overall agreement should make no difference to the taxability of the equipment supplied by the assessee."

In paragraph 15, the Hon'ble Court has further observed that no doubt the contract in question was signed in India but it may not be a relevant circumstance to determine the taxability of such an income and for this proposition they have referred the judgment of Hon'ble Andhra Pradesh High Court in the case of **Skoda Export v/s. Addl. CIT, (1983) 43 ITR 452.** Finally in paragraph 17 as incorporated above, Hon'ble High Court has categorically said that the taxable event took place outside India with the passing of the property from seller to buyer and acceptance test is not the determinative of this factor and further referring to the judgment of Hon'ble Supreme Court in the case of **Mahabir Commercial Co. Ltd. vs. CIT, (1972) 86 ITR 147 (SC),** held that overall agreement does not result the income accruing in India and the execution of an overall agreement is promoted by purely commercial considerations as India Cellular Operator would be desirous of having a single entity that

could liaise with. Thus, it was concluded that the place of negotiation, the place of signing of agreement or formula acceptance thereof or overall responsibility of the assessee are relevant circumstances. Since the transaction is relating to the sale of goods, the relevant factor and determinative factor would be as to where the property in good passes and in the present case, the finding is that the property has passed on high seas. In the present case, the goods were manufactured outside India and even the sale has taken place outside India and once this fact is established even in those cases where there is a one composite contract supply has to be segregated from installation and only then would question of apportionment arise having regard to expressed language of Section 9(1)(i) of the Act, which makes the income taxable in India to the extent it arises in India.

57. Whence in the concept of LO already a categorical finding has been given by the Hon'ble High Court that supply of off-shore equipment which has been done outside India cannot be held to be taxable in India, then the same principle and proposition would also be applicable in the case of NIPL also, because, so far as the supply contracts are concerned there is absolutely no change in the facts and circumstances as even after the NIPL is incorporated in May, 1995, the off-shore supply equipment and the supply contract remained the same. The marketing activities and installation contract undertaken by NIPL has been on principal to principal basis; and in the case of former agreement between assessee and

NIPL, the payment has been made to NIPL on cost plus markup basis which has not been disturbed; and in the later agreement there is an independent contracts by NIPL with Indian customers which has nothing to do with the assessee. The income arising from both the contracts are taxable in the hands of the NIPL in India. Thus, the finding and the ratio of the Hon'ble High Court would apply *mutatis mutandis* though rendered in the context of LO will also apply in the case of NIPL as *qua* the supply contract there is no material change in any case.

58. Apart from the judgment of Hon'ble Delhi High Court in the case of assessee as discussed above, we find that, Hon'ble High Court in **Nortel Network India International Inc. (supra)** somehow on similar set of facts has reiterated the same principle. Before that the relevant facts in the said case were as under:-

> *The assessee was incorporated in the USA and was a tax resident of the USA. The assessee was a part of the N group which was stated to be a leading supplier of hardware and software for global system for mobile communication cellular radio telephone systems. The assessee was a step-down subsidiary of N, a company incorporated in Canada. N(C) also had an indirect subsidiary in India N (I). N (I) negotiated and entered into three contracts with R, namely, optical equipment contract, optical services contract and the software contract on June 8, 2002. On the same date, N (I) entered into an agreement assigning all rights and obligations to sell, supply*

and deliver equipment under the equipment contract to the assessee. R and N(C) were also parties to the assignment contract and in terms thereof, N(C) guaranteed the performance of the equipment contract by the assessee (assignee). In terms of the assignment contract, R placed purchase orders directly on the assessee and also made all payments for the equipment supplied directly to the assessee. The equipment supplied to R was manufactured by N(C) and another group entity in Ireland. The same was invoiced by the assessee directly to R and consideration for it was received directly by the assessee. The Assessing Officer held that income arose to the assessee in India and was assessable. The Commissioner (Appeals): held that keeping in view the facts of the case, 50 per cent, of the assessee's estimated profits could be attributed to the permanent establishment in India. This was upheld by the Tribunal. The Income-tax authorities concluded that the assessee was *a shadow company of N(C) and both the companies were essentially a singular entity. In other words the Income-tax authorities disregarded the corporate structure of the assessee and proceeded on the basis that its identity was the same as N(C).*

On the issue, whether the appellant had a PE, both fixed place PE and DAPE in India in the terms of liaison office Nortel Canada and also in terms of subsidiary Nortel Network India Pvt. Ltd. which carried out installation services, Hon'ble High Court observed and held as under:-

"It is apparent from the plain reading of Section 9(1) of the Act

that all income which accrues or arises through or from any business connection in India would be deemed to accrue or arise in India. In CIT v. *R.D. Aggarwal & Co.: (1965) 56 ITR 20 (SC), the Supreme Court observed that business connection would mean "a relation between a business carried on by a non-resident and some activity in the taxable territories which are attributable directly or indirectly to the earnings, profits or gains of such business". However, by virtue of Explanation 1 to Section 9(1) of the Act, only such part of the income which is reasonably attributable to operations carried out in India would be taxable. Thus, if it is accepted that the Assessee has received only the consideration for the equipment manufactured and delivered overseas, it would be difficult to uphold the view that any part of Assessee's income is chargeable to tax under the Act as no portion of the said income could be attributed to operations in India.*

44. There is little material on record to hold that Nortel India habitually exercises any authority on behalf of the Assessee or Nortel Canada to conclude contracts on their behalf. There is also no material on record which would indicate that Nortel India maintained any stocks of goods or merchandise in India from which goods were regularly delivered on behalf of the Assessee or Nortel Canada. Thus, by virtue of Explanation 2 read with Explanation 3 to Section 9(1) (i) of the Act, no part of Assessee's income could be brought to tax under the Act. It is only when a non-resident Assessee's income is taxable under the Act that the question whether any benefit under the Double Taxation Avoidance Treaty is required to be examined.

xxx xxx xxx xxx xxx xxx

47. As noticed earlier, there seems to be no dispute that the title to the equipment passed in favour of Reliance overseas. However, the AO, CIT (A) and ITAT did not consider the same to be relevant as according to them, the equipment continued to be in the possession of the "Nortel Group" till its final acceptance by Reliance. In our view, even if it is accepted that the equipment supplied overseas continued to be in possession of Nortel India till the final acceptance by Reliance, the same would not imply that the Assessee's income from supply of equipment could be taxed under the Act. Clause (a) of Explanation 1 to Section 9(1)(i) of the Act postulates the principle of apportionment and only such income that can be reasonably attributed to operations in India would be chargeable to tax under the Act. The position in Ishikawajima-Harima Heavy Industries (supra) was also similar. There too, the equipments were supplied overseas and the contractor continued to retain control of equipment and material till the provisional acceptance of the work or the termination of the contract."

Thus, the Hon'ble High Court in Nortel's case has clearly concluded that equipments supplied overseas cannot be taxed under the Act and as per clause (a) of Explanation 1 to Section 9(1)(i) which postulates the principle of apportionment, the only such income that can be reasonably attributed to assessee in India could be chargeable to tax under the Act and therefore, under the fact where there is off-shore supply of equipments nothing can be held to be taxed in India in terms of Section 9(1). In fact, in the finding of the

Hon'ble High Court in paragraph 69 to 72, it has been held that the Indian subsidiary of Nortel and LO will not constitute a PE. For the sake of ready reference, paragraphs 69 to 72 are reproduced hereunder:-

> 69. *The AO, CIT (A) and ITAT have held that the office of Nortel India and Nortel LO constituted a fixed place of business of the Assessee. As pointed out earlier, we find no material on record that would even remotely suggest that Nortel LO had acted on behalf of the Assessee or Nortel Canada in negotiating and concluding agreements on their behalf. Thus, it is not possible to accept that the offices of Nortel LO could be considered as a fixed place of business of the Assessee. In so far as Nortel India is concerned, there is also no evidence that the offices of Nortel India were at the disposal of the Assessee or Nortel Canada. Even if it is accepted that Nortel India had acted on behalf of the Assessee or Nortel Canada, it does not necessarily follow that the offices of Nortel India constituted a fixed place business PE of the Assessee or Nortel Canada. Nortel India is an independent company and a separate taxable entity under the Act. There is no material on record which would indicate that its office was used as an office by the Assessee or Nortel Canada. Even if it is accepted that certain activities were carried on by Nortel India on behalf of the Assessee or Nortel Canada, unless the conditions of paragraph 5 of Article 7 of the Indo-US DTAA is satisfied, it cannot be held that Nortel India constituted a fixed place of business of the Assessee or Nortel Canada.*
>
> 70. *The AO has further alleged that the offices of Nortel LO*

and Nortel India were used as a sales outlet. In our view, this finding is also unmerited as there is no material which would support this view. The facts on record only indicate that Nortel India negotiated contracts with Reliance. Even assuming that the contracts form a part of the single turnkey contract, which include supply of equipment - as held by the authorities below - the same cannot lead to the conclusion that Nortel India was acting as a sales outlet.

71. *The AO's conclusion that there is an installation PE in India, is also without any merit. A bare perusal of the Services Contract clearly indicates that the tasks of installation, commissioning and testing was contracted to Nortel India and Nortel India performed such tasks on its own behalf and not on behalf of the Assessee or Nortel Canada. Undisputedly, Nortel India was also received the agreed consideration for performance of the Services Contract directly by Reliance.*

72. *The finding that Nortel India is a services PE of the Assessee is also erroneous. There is no material to hold that Nortel India performed services on behalf of the Assessee.*

73. *The AO has also held that Nortel India constituted Dependent Agent PE of the Assessee in India. The aforesaid conclusion was premised on the finding that Nortel India habitually concludes contracts on behalf of the Assessee and other Nortel Group Companies. In the present case, there is no material on record which would indicate that Nortel India habitually exercises authority to conclude contracts for the Assessee or Nortel Canada. In order to conclude that Nortel India constitutes a Dependent Agent PE, it would be necessary for the AO to notice at least a few instances where*

contracts had been concluded by Nortel India in India on behalf of other group entities. In absence of any such evidence, this view could not be sustained.

74. *The CIT (A) as well as the ITAT has proceeded on the basis that the Assessee had employed the services of Nortel India for fulfilling its obligations of installation, commissioning, after sales service and warranty services. The ITAT also concurred with the view that since employees of group companies had visited India in connection with the project, the business of the Assessee was carried out by those employees from the business premises of Nortel India and Nortel LO. In this regard, it is relevant to observe that a subsidiary company is an independent tax entity and its income is chargeable to tax in the state where it is resident. In the present case, the tax payable on activities carried out by Nortel India would have to be captured in the hands of Nortel India. Chapter X of the Act provides an exhaustive mechanism for determining the Arm s Length Price in case of related party transactions for ensuring that real income of an Indian Assessee is charged to tax under the Act. Thus, the income from installation, commissioning and testing activities as well as any function performed by expatriate employees of the group companies seconded to Nortel India would be subject to tax in the hands of Nortel India and the same cannot be considered as income of the Assessee."*

This judgment of Hon'ble Delhi High Court clearly clinches the issues in hand, both on the point of taxability u/s. 9(1)(i) and also in the context of PE. Thus, respectfully following the

ratio laid down in aforesaid judgment of Hon'ble High Court in the case of assessee as well as in the case of Nortel, we hold that income of the assessee from off-shore supply of equipments in pursuance of supply contract cannot be brought to tax in India.

59. Since we have already held that nothing is taxable on account of signing, network planning and negotiation of off-shore supply contracts, therefore, there is no question of any attribution of income on account of these activities which are purely related to supply contracts. Accordingly, the issue of attribution which has been remanded back by the Hon'ble High Court has become purely academic.

60. Now coming to the last issue of taxability of interest from Vendor Financing, we find that the Assessing Officer in his order has made the addition on the ground that assessee provided credit facilities to its customers for which it should have charged the interest on the same. For coming to this conclusion, he has referred to one clause given in paragraph 6.9 of the contract between the assessee and Modi Telstra to conclude that purchaser were liable to pay interest @18% for each day elapsed from the due date of actual payment. Thus, the only reason for making such an addition was existence of a particular clause in the agreement signed between the assessee and some of the Indian Cellular Operators. The ld. CIT (A) too has confirmed the said addition on the ground that, since the assessee is following a mercantile system of

accounting and as per the contract assessee was entitled to receive such interest, and therefore, same should have been accounted for and in support he has relied upon the judgment of Hon'ble Supreme Court in the case of State Bank of Travancore (supra). Ld. counsel for the assessee had submitted that the said judgment has already been distinguished in the subsequent judgment of Hon'ble Supreme Court in the case of UCO Bank vs. CIT (supra) and secondly, only the real income can be brought to tax and not something on hypothetical basis, because there has to be corresponding liability to the other party to whom the income becomes due and here such a clause was never enforced by the parties. Already the arguments of both the parties have been incorporated in earlier part of the order; therefore, same is not being discussed again.

61. After considering the relevant finding and rival contentions, we find that, it has not been brought on record that in any of the contract the assessee had charged any interest on delayed payment or providing any credit facilities to its customers or any customer has paid any such amount for each day elapsed from the due date to the actual payment. Once none of the parties have either acknowledged the debt or any corresponding liability of the other party to pay, then it cannot be held that any income should be taxed on notional basis which has neither accrued nor received by the assessee. Whence the benefit of credit period given to the customers has neither accrued to the assessee nor acknowledged by the

other person, then it cannot be said that interest on notional basis should be calculated for the purpose of taxation. Otherwise, it is a well settled proposition that income cannot be generated, actual or accrued if no income has actually been accrued or received to the assessee. There has to be some income which has resulted to the assessee and even though in books, entries have been made about hypothetical income which does not materialized at all cannot be brought to tax. The income tax is levy on real income, i.e., the profits arrived on commercial principles. Assessee must have received or acquired a right to receive the income before it can be taxed. In other words, there must be a debt owed to it by somebody if it is to be taxed on accrual basis unless a debt has been created in favour of the assessee by somebody it cannot be said that income has accrued to it or it has a right to receive the income. This proposition has been well settled by Hon'ble Supreme Court in the case of **E. D. Sassoon Co. Ltd. Vs. CIT, (1954) 26 ITR 27 (SC), CIT vs. Ashokbhai Chaamanbhai, (1965) 56 ITR 42, CIT vs. Shoorji Vallabhdas and Co, (1962) 46 ITR 144 (SC) and Godhara Electricity Company Ltd. Vs. CIT, 225 ITR 746**. Further, the judgment of Hon'ble Supreme Court in the case of State Bank of Travancore, reported in (1986) 158 ITR 102 (SC) which has been relied upon by the ld. CIT (A), has not been treated to be correct enunciation of law by the Hon'ble Supreme Court in the case of Godhara Electricity Company Ltd. v/s. CIT (supra) and UCO Bank vs. CIT (supra). Here in

the present case, the assessee itself has not treated the amount of interest to be due from any of the telecomm operators either recognised as a debt or as a legal claim. Even the conduct of the parties show that such a clause even though may have been agreed upon has never been enforced or acted upon. In such a situation, in our opinion, the amount of interest cannot construe a debt due to the assessee. Further, assessee has not debited the account of any customer with interest which can be treated as income of the assessee. Nowhere has it been held by the Assessing Officer/CIT (A) that such an interest is legally claimable right against the Indian customers in respect of interest on delayed credit period on Vendor Financing. Thus, we hold that when assessee has neither treated the amount to be legally claimed nor has acknowledged any debt due too on its customer as delayed payment then it cannot be held that any interest accrued to the assessee, and therefore, such a notional charging of interest for each day elapsed from the due date to the actual payment cannot be held to be taxable to the assessee. This proposition has also been now well upheld by Hon'ble Supreme Court in the case of **CIT vs. Excel Industries Ltd., (2013) 358 ITR 259 (SC).** Hence, no income can be said to accrue to the assessee on account of delayed payments as neither there was any corresponding liability on any of the debtors nor assessee had claimed any entitlement on such an interest. Accordingly, this issue is also decided in favour of the assessee.

62. The aforesaid findings and conclusions given in respect for the A.Y. 1997-98, will apply *mutatis mutandis* in the appeal for the A.Y. 1998-99 year, as exactly similar facts and issues are permeating in this year also.

63. In the result, all the issues which have been remanded back by the Hon'ble High Court to this Tribunal stands decided in favour of the assessee and against the Revenue.

Order pronounced in the open Court on 5th June, 2018.

----	**Sd/xx**	**Sd/xx**
(PRAMOD KUMAR)	**(N.K. SAINI)**	**(AMIT SHUKLA)**
(ACCOUNTANT MEMBER)	**(ACCOUNTANT MEMBER)**	**(JUDICIAL MEMBER)**

DATED: **05th June, 2018**

PKK:

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

Assistant Registrar

My separate note attached

Sd/xx
Pramod Kumar
Accountant Member

IN THE INCOME TAX APPELLATE TRIBUNAL,
DELHI SPECIAL BENCH 'A', NEW DELHI
[Coram: N K Saini AM, Pramod Kumar AM and Amit Shukla JM]

ITA Nos. 1963 and 1964/Del/2001
Assessment years: 1997-98 and 1998-99

Nokia Networks OY, Finland **…………..........Appellant**
[PAN: AAACS0343R]

Vs

Joint Commissioner of Income Tax
Non Resident Circle, New Delhi **……….……......Respondent**

<u>Per Pramod Kumar:</u>

1. I have my reservations on the views expressed in the draft order, so far as the questions of existence of a business connection and permanent establishment of the assessee company and the profit attribution thereto is concerned. These issues were discussed at length with my distinguished colleagues on this Special Bench but all that these discussions have yielded is a revised and more elaborate draft on the same lines finalized, and duly initialled, by both of my distinguished colleagues. The majority view is thus already expressed and outcome of this appeal, at this stage, is now *fait accompli*. In that sense, my views have no impact on the outcome of the appeal at this stage and now it is purely an academic exercise to express my views. I must, nevertheless, proceed with writing my separate note, exactly on the same lines as was discussed in our post hearing discussions upon conclusion of hearing. My deepest regards for my colleagues on the bench, and highest respects for their views, apart, it is my duty to conscientiously express my views on what comes up for the judicial consideration, and I must not fight shy of performing these duties or of being in minority in my take on the matter. With all my respect for the majority view, I venture to add my detailed note on the points on which I am unable to share the perceptions of the majority.

<u>The backdrop</u>

2. I consider it appropriate to add my perceptions about the backdrop of this case as well. The relevant material facts, so far as relatable to the limited issue that I am writing my separate note on, are like this. The assessee is a company incorporated, and fiscally domiciled, in Finland, and is engaged in the business of manufacturing and trading of telecommunication hardware and software. There is no dispute that the assessee is entitled to the benefits of India Finland Double Taxation Avoidance Agreement [(1985) 152 ITR (St) 57; Indo Finnish tax treaty, in short], as it then stood. During the relevant period, the assessee had a liaison office in India as also a wholly owned subsidiary by the name of Nokia India Private Limited. In 1997-98 and 1998-99, the assessee is said to have executed, and received payments for, seven contracts for sale to equipment to, namely,- BPL West

Telecommunication Services Pvt Ltd, Fascel Limited, Tata Communications Ltd, Evergrowth Telecom Limited, Modi Telstra India Ltd, Skycell Communications Ltd and Supreme. The Assessing Officer was of the view that "the assessee has a permanent establishment in India". He was of the view that the assessee company had a PE in the form of its India office and it's Indian subsidiary. The Assessing Officer noted that the assessee company had opened its India liaison office in 1994, with Mr Hanu Karavitra as its country manager, and the same Mr Karnavitra was later Managing Director of the Nokia India Pvt Ltd- assessee's wholly owned subsidiary in India. The Assessing Officer also noted that "Indian office was not merely a liaison office but was a proper office where contracts were signed and terms were negotiated" and that "while working in India, Mr Karavitra was receiving salaries from the assessee company also". The Assessing Officer took note of the role played by the assessee company in he operations of Indian subsidiary, and then discussed the contents of certain contracts to highlight that awarding of technical support services contracts, in respect of the equipment supplied by the assessee company, involved a specific undertaking to the end customer to the effect that "as long as any part of the commitments under the technical support agreement remain outstanding, we will continuously and diligently monitor business affairs of Nokia India with the aim of ensuring that the company at all times is in a position to meet its commitments to you" and that "as long as any part of technical support agreement are not performed, we shall not dispose of our ownership of Nokia India Pvt Ltd below 51% without your prior written permission". He was of the view that in the light of this position, "the assessee company has a permanent establishment in India in the form of its Indian subsidiary, which is a dependent agent permanent establishment". He then referred to, and reproduced, the provisions of Article 5 and 7 of the then Indo Finnish tax treaty. In a verbose order, the Assessing Officer analysed facts of the facts in detail. He noted that "the employees of the Indian company were accompanying the foreigners (representing the assessee company) during their meetings with the customers" and "even subsequent follow up was done by the Indian company". It was noted that Managing Director of Indian subsidiary, in a statement recorded by the Assessing Officer on oath and in response to the question that " (while) as per agreement with Nokia Telecommunications OY (as the assessee company was known at that point of time) and the customer, the Nokia Finland (i.e. the assessee company) has to go support locally, how has it been carried out", it was stated that "we carry out (these services) by using the human resources and facilities available in India". The Assessing Officer was of the view that "supply of telecom equipment is a highly technical field; no equipment is sold unless the installation work and after sales services are carried out by the same company". The Assessing Officer also referred to a letter dated 15th June 1996 addressed by the assessee company to Tata Communications Limited wherein a mention is made about the company's guarantee and comfort letter in respect of services rendered by the Nokia India Pvt Ltd. This guarantee and the comfort letter, inter alia, states as follows:

> This is to confirm that we, Nokia Telecommunications OY, a company duly registered and existing under the laws of the Republic of Finland, are fully aware that you have awarded a contract to Nokia Telecommunications Pvt Ltd (Nokia India) for installation, testing and commissioning of GSM Digital Cellular Mobile Telephone Network of Tata Telecommunications Ltd and for the performance of various other services and activities in connection therewith (the service contract).

> We, the undersigned company, hereby guarantee in your favour the due and timely discharge and performance, in accordance with the said services contract, of all the obligations and liabilities of Nokia India arising from and pursuant to the said services contract.
>
> This guarantee constitutes an independent and legally valid undertaking in your favour. We represent to you that it is duly approved by the Directors, Nokia Telecommunications OY

3. The Assessing Officer was of the view that the above arrangement shows that the Indian subsidiary of the assessee company is a permanent establishment of the assessee company. His reasoning, as set out at page 21 of the assessment order for the assessment year 1997-98, was as follows:

(a) The Indian subsidiary company is a dependent agent of the assessee company because (a) even though the Indian subsidiary company has concluded contracts with various cellular companies for installation of equipment and services, the entire responsibility rests with the assessee company; (b) the assessee company has given written guarantee to the effect that it will be responsible for proper discharge of obligations by the Indian subsidiary; and (c) the assessee company has even given undertaking that, except with the prior written approval of the vendor with which the Indian subsidiary has entered the contract, the assessee company will not dilute its shareholding in the Indian company below 51%. The Assessing Officer thus pointed out that the assessee company was in full control and the Indian subsidiary was no more than an agent of the assessee company.

(b) The contract entered into by the Indian companies with the end customer specifically provided, such as in Article 19 of the contract, that "any notice sent by the cellular operator to Nokia India must be sent to Nokia Telecommunications OY also". The AO was of the view that such an arrangement was a clear evidence of the fact that there was close business connection between the assessee company and its Indian subsidiary. The suggestion apparently was that the business connection was so close that the Indian company was no more than an agent of the assessee company for all practical purposes.

(c) The assessee company has provided a twelve month warranty to the purchaser of equipment and during this warranty period, the Indian subsidiary is providing services to the purchaser of equipment. The AO was of the view that clearly all the responsibilities under the warranty clause of the agreement between the assessee and the customer have been discharged by the assessee company as is evident from the following provision in contract with Tata Cellular:

> The purchaser shall carry out the necessary work to identify and locate the defect. The supplier agrees to provide the technical assistance reasonably required for such fact finding work upon request or the supplier will procure that an affiliate of the supplier will provide such assistance to the purchaser

under such terms and conditions as my be mutually agreed between the said affiliate and the purchaser under a technical support agreement.

Infact an attempt was thus made to demonstrate that the technical support arrangement was an integral part of the arrangement between the assessee company and the end buyer and that it could not be considered in isolation with assessee's business.

(d) It was also noted that "expatriate employees of the Indian company (Nokia India), who were responsible for installation work etc, were employees of the assessee company or its associated enterprises" The Assessing Officer was of the view that "there was no reason for the assessee company to incur costs on behalf of the Indian company". It was noted that "the Indian company has not been paid any compensation by the foreign company during the year". He thus concluded that, for this reason, it is clear that the Indian subsidiary is acting as a dependent agent of the assessee company.

(e) The Assessing Officer then noted that the Indian subsidiary was "economically dependent" on the assessee company, as "all its shares are held by Nokia Telecommunications OY and all its receipts are from contracts executed by it for supplies made by Nokia Telecommunications OY" and as "there is total control over the management and affairs of Nokia Telecommunications Pvt Ltd since its is a 100% subsidiary and further the foreign company is giving guarantee on behalf of Indian that they (the assessee company) will see to it that contracts are properly executed"

4. Having so analysed the facts of the case, the Assessing Officer proceeded to form his opinion about these arrangements, at page 25 of the assessment order for the assessment year 1997-98, as follows:

In the light of the aforesaid facts, it is clear that the Indian company is nothing but an extension of the foreign company and there is no basis of arm's length principle. The capital is contributed by the assessee company, the knowhow has been given by the assessee company for installation work, the expatriate employees have been provided by the assessee company, part of salary cost has been absorbed by the assessee company or its associated companies, the warranty and after sale service has been provided by the Indian subsidiary on behalf of the assessee company (and) the Indian company was providing the marketing support and coordination on behalf of the foreign company. All these facts clarify that the incorporation of Indian company was a veil to avoid the taxability of the foreign company on profits earned through the supplies made by the assessee company.

5. The Assessing Officer once again resumed his analysis of facts and highlighted the fact that it is only upon the issuance of certificate by the Indian subsidiary, that the equipment is properly installed and is properly functioning, that sale gets concluded. He was thus of the

view that the work of the Indian subsidiary was in conjunction with the work of the assessee company, and for this reason, the Indian subsidiary should be treated as a PE of the assessee company. While he did refer to the expression 'Dependent Agent Permanent Establishment' most of the time, the reference was for the Indian subsidiary being treated as PE of the assessee company on account of closely related commercial activity. It was then observed that, in any case, the assessee also had a fixed place of business in India. It was noted that "the local office, which was opened in March 1994, was in fact providing a fixed place of business for assessee in marketing its products", that "infact, this office provided an interface between the customer and the assessee company" and that "this office was collocated with Indian company and all the expenditures may have been shifted to the Indian company, whereas the activity (of the assessee company) was carried through this office". It was also noted that "before a contract was signed, a number of expatriates would came to India, stayed in India and carried out network planning" and "they were also involved in negotiating the deal with various customers and were interacting with them on regular basis" which would not have "been possible without the assessee having a fixed place of business from which it carried out these operations" and "this fixed place of business was the liaison office together with Indian company". It was also noted that the visiting staff of the assessee company were given all the administrative support at this location, that "the Indian company was maintaining stocks of spare parts for replacement under the warranty period" and that "the Indian company provided the helpline facility for any type of problems accruing to the customer". He then referred to certain dates and the signatories of the contracts, an aspect on which facts have been set out fairly elaborately in the lead order, and I, therefore, need not really supplement the same. Suffice to say that conclusion of the Assessing Officer was that the assessee company had a PE in India, and then, after taking note of the fact that gross profit of the assessee company was 40.87% in 1997 and 39.4% in 1996, the Assessing Officer adopted 40% as the gross profit earned by the assessee for the assessment year 1997-98. The net sales, converted into INRs, being Rs 146,61,61,361, the gross profit was worked out at Rs 41,05,25,180 by assuming that hardware sale was 70% of total sales. Allowing a deduction of 5% under section 44C and noting that there was no claim of expenses incurred in India operations, the Assessing Officer computed the profits attributable to the PE at Rs 38,99,98,921 for the assessment year 1997-98. Using the same methodology, but with total sale figure of Rs 84,51,41,736 for the assessment year 1998-99, the taxable profit attributable to the PE was worked out at Rs 10,97,07,697. Aggrieved by the stand so taken by the Assessing Officer, assessee carried the matter in appeal before the CIT(A) but without complete success. While the CIT(A) did reduce the profit attributable to the Indian PE to 5% of total sales, he confirmed the conclusion of the Assessing Officer with respect to existence of a PE. We may, in this regard, refer to the following portion of his operative order for the assessment year 1997-98 which was also adopted, by a separate order, for the assessment year 1998-99 as well:

> **6.3 The assessee had also a wholly owned subsidiary in India. It has been pointed out earlier that representation was made to the Indian operators that the assessee would to ensure that the installation contract was carried out fully by the IC, and the assessee would fully support the IC in discharge of its obligations under the contract. Not only that it was also represented that the assessee will not dilute its activity below 51% in the IC without the written permission of the**

Indian operator. In view of these representations and the counter undertakings given by the assessee and the IC, it cannot be said that the IC acted independently in discharge of its obligations under the contracts. In the course of appellate proceedings a copy of the order in case of the IC was filed. According to this order the company incurred book loss of about Rs.10 crore. Even if the depreciation of about Rs.2 crores is ignored, than the loss before depreciation would about Rs. 8 crore. The IC had two streams of income, namely, commission from the assessee under the marketing agreement and installation charges from the Indian operator. The case of the assessee was that in respect of marketing agreement, the IC was compensated on cost plus 5% basis which was claimed to be reasonable. If this argument is taken to be correct, then it can be said that the loss occurred on account of installation contracts. In other words, it lends credence to the AO's assertion that the IC was not properly remunerated under the contracts, guaranteed by the appellant and a part of money that it ought to have got was diverted as sale proceeds of the equipment. Nonetheless, even if this argument is rejected, the fact is that the IC incurred substantial loss and, therefore, it was not properly remunerated for the services rendered by it either in respect of marketing agreement or in respect of installation contracts. The IC is a wholly owned subsidiary of the appellant and, therefore, appellant was in the knowledge of prices put on the installation contracts. It had wide experience in this line of business and yet the IC undertook business in a manner that, it incurred substantial losses. Therefore, it cannot be said that the transactions between the assessee, the operators, and IC were at arms length. In fact the agreements by the assessee with the Indian operators on one hand and IC with the Indian operators on the other can be said to have been arranged in a manner that loss would be incurred in the IC. In view thereof, there is reason to hold that the IC constituted the PE of the assessee and observed losses on behalf of the assessee. In the context of these facts, it will be difficult to hold that the assessee and the IC acted independently in so far as their businesses are concerned and it will more appropriate to hold that the IC merely acted at the instructions of the assessee in respect of installation and marketing contracts. It was also the case of the assessee that certain averment in Appendix 6 to the effect that Indian subsidiary assumed responsibilities on behalf of the appellant for timely supply of equipment were wrongly made. But no evidence has been filed that the written agreement contained inaccurate statements. We have also seen that the appellant himself has taken up the responsibility on behalf of the subsidiary company and has gone to the extent of holding out that its equity will not be diluted below 51% till installation contract is completed, except with written permission of the Indian operator. This strengthens the view that the assertions of the assessee in the matter are not correct. Accordingly, it is held that the ld. AO was right in holding that the appellant had a PE in India through the office of the IC.

7. Coming to the issue of the computation of income on sale of hardware, the ld. AO observed that the gross profit of the assessee was 28.7% while the operating profit was 10.8% in the year ended on 31.12.96. However, thereafter, without assigning any reason he estimated the profit margin on sale of hardware at 10% of the total sale. The view of the ld. Counsels was that the Indian

> **Telecom Industry had been passing through a bad phase in that period and Indian operators were incurring heavy losses. The assessee was a new entrant in this highly competitive market and it had to make significant initial investment for gaining market share. Copies of P&L a/c for Indian tax purposes for financial years 1996-97 and 1997-98 were filed in the paper book as item 6 of section 3. This showed a loss of U.S. dollars 2,37,52,669 for the year ended 31.3.97. The sales were shown at US Dollars 1,57,51,391. On the face of it, there appears to be something wrong with the P&L a/c as direct costs were shown at U.S. Dollar 2,10,24,054. This is in the context worldwide gross profit of 28.7%. This P&L a/c was not substantiated with any documents. Therefore, it is held that these accounts are not reliable for the purpose of computing income from sale of hardware. Accordingly, assistance of Rule 10 of the I.T. Rules is taken to compute profit on the basis of global accounts. The global accounts showed net profit of 10.8% as mentioned by the Ld. AO in the assessment order. Therefore, the net profit is taken at 10.8%. The whole of this profit cannot be attributed to Indian operations as activities regarding manufacture and development of products etc. was undertaken outside India. Therefore, the profits attributable to operations in India are taken at 5% of the sales to the Indian Parties.**

6. Aggrieved by the stand so taken by the CIT(A), assessee carried the matter in appeal before this Tribunal, and, in the first round of proceedings, a coordinate special bench of the Tribunal concluded, in a rather brief operative portion of the order on this point, as follows:

> **Taking up the second part of the second question as to whether the Indian subsidiary of the assessee, referred to as NTPL, can be considered as a PE of the assessee in India, we are of the view that having regard of the findings recorded by both the AO and the CIT(A), the NTPL can be considered as a PE. The issue has been dealt with in para 6.3 of the order of the CIT(A), though in several earlier parts of the order, there is scattered reference to this aspect of the matter. However, the final decision of the CIT(A) is only in para 6.3 of his order. A reading of this paragraph shows clearly that what the CIT(A) has in mind, as in the case of the AO, is that NTPL, the Indian subsidiary, is the virtual projection of the assessee itself in India, though this idea may not have been properly articulated in the orders of the IT authorities. The main point brought out by them is that in respect of the services rendered by NTPL to the assessee under the "marketing agreement", it was compensated on the basis of cost plus 5 per cent which means that in addition to getting the expenses reimbursed, NTPL will get 5 per cent more. It stands to reason that in respect of the marketing activity, NTPL has no scope for incurring any loss. Nevertheless, its accounts show a book loss of Rs. 10 crores (approximately) and even if the depreciation loss of Rs. 2 crores is ignored, still the loss is around Rs. 8 crores. The question posed by the IT authorities is: where from this loss has arisen? The answer is that such a loss has arisen only from the installation activity carried out by the NTPL. In other words, the installation charges received by NTPL from the cellular operators in India were not commensurate with the costs and expenses incurred therefor and that is the reason why such a loss has been incurred. Now the other question is**

how does this result in NTPL being regarded as the PE of the assessee-company. The answer is that since NTPL is a wholly owned subsidiary of the assessee in India and is consequently in a position to control and monitor its activities, the installation charges were directed to be so fixed that they were not commensurate with the services rendered by NTPL. The next question will be why would the assessee do so. We cannot think of any other reason except that the part of the price for installation of the GSM equipment was diverted as the price for the supply contract. Whether there is direct evidence or not for this conclusion, or whether it is permissible for us even to make such an inference from the circumstances of the case, is not really material for the present purpose. What is material is that there was ample scope for the assessee to control and monitor the activities of NTPL which, it should be remembered, is a 100 per cent subsidiary of the assessee, in such a manner that NTPL became a virtual projection of the assessee-company in India. The other point made by the IT authorities was that the assessee even represented to the Indian cellular operators that it will not dilute its share holding in the Indian subsidiary below 51 per cent without the written permission of the Indian cellular operators. This allegation of the IT authorities has not been refuted or proved wrong by the assessee in the course of the proceedings before them or even before us. This also shows that the distinction between the two corporate entities, namely, the assessee on one hand and NTPL, its 100 per cent subsidiary, on the other hand, virtually got blurred with the result that it can be said that when the Indian cellular operators were dealing with NTPL in connection with the installation contract and marketing agreement, they were in fact dealing with the assessee itself. We are therefore, of the opinion that the test propounded by the Andhra Pradesh High Court in the case of CIT vs. Visakhapatnam Port Trust (supra) is fully answered. We are, therefore, unable to find fault with the CIT(A) for holding that NTPL, the 100 per cent Indian subsidiary of the assessee, constituted the assessees PE in India.

7. The conclusions so arrived at by the Special Bench were challenged by the assessee before Hon’ble Delhi High Court, and the questions framed for consideration by Their Lordships were as follows:

1. **Whether on a true and correct interpretation of the relevant DTAA the Tribunal's reasoning is right in law in holding that NIPL, (the subsidiary of the Appellant) is a permanent establishment?**

2. **Whether the Tribunal was right in law in holding that a perception of virtual projection of the foreign enterprise in India results in a permanent establishment?**

3. **Without prejudice, if the answers to Q.1 & Q.2 are in affirmative, is there any attribution of profits on account of signing, network planning and**

negotiation of offshore supply contracts in India and if yes, the extent and basis thereof?

4. **Whether in law the notional interest on delayed consideration for supply of equipment and licensing of software is taxable in the hands of assessee as interest from vendor financing?**

8. Their Lordships noted the contention of the assessee that the Special Bench "**did not go into the issue of how much income can be attributed to the activities carried out in India because that analysis was only made in respect of the subsidiary constituting a PE**", that "**it was necessary to ascertain as to whether any income was attributable to the PE**", and that "**no such income could be attributed to PE in India and these aspects were not correctly appreciated by the Tribunal**". It was also contended before Their Lordships that "**various factual errors which has crept in the orders of the lower authorities**". Hon'ble High Court, in this background, observed, inter alia, as follows:

> "**Mr. Parasaran, learned ASG appearing for the Revenue could not controvert the aforesaid pleas……. We find that the aforesaid errors on facts have crept in. It is primarily for the reason that the Tribunal had taken the facts in the case of Ericsson case and on the presumption that those facts were common the case of Nokia as well and the legal questions in the appeals of Nokia were decided therefore the actual inaccuracy has crept in the fact findings of the Tribunal………..We would like to record that the CIT(A) proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability. The CIT(A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian subsidiary did not occur at arm's length. Mr. Syali argued that there was no basis for drawing such inference and at the time of arguments, the learned ASG conceded that there was no evidence to support that losses were absorbed by the Indian company. Again, pertinently, the Tribunal also observed that NIPL could be considered PE of assessee in India being subsidiary as it is the virtual projection of the company in India. Further, the accounts of the Indian subsidiary show that the company incurred huge losses as it was not compensated properly for the installation work carried on by it. In the opinion of the ITAT since it was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary. The learned ASG also conceded that it was not correct**".

9. It was in this backdrop of these factual errors, as noted by Their Lordships, that Hon'ble Delhi High Court referred the matter back to this Tribunal by observing as follows:

> **38. As we find that the order of the Tribunal is based on many <u>factual errors</u>** *(emphasis by underlining supplied by me now)* **which are even accepted by the Revenue before us, it would be appropriate to refer the matter back to the Tribunal for fresh consideration on the issues as to whether the subsidiary of the**

assessee would provide business connection or is Permanent Establishment and even if it is so, is there any attributes of profits on account of signing, under working, planning and negotiation of off-shore supply contracts in India. If yes, to what extent and basis thereof. Likewise, the question of notional interest on delayed consideration of supply of equipment and liaisoning of software taxable in the hands of assessee as interest from vendor financing would be considered afresh. The appeals of the assessee are thus disposed of with the aforesaid direction remitting the case back to the Tribunal for fresh consideration on these issues.

10. Let me, at this stage, make careful note of the factual mistakes, as pointed out by Hon'ble high Court, to have crept in the order of the Special Bench:

- The special bench did not at all deal with the quantification aspect of the profits attributable to the PE. ***[This is an error in the nature of error of omission committed by the Tribunal]***

- The special bench proceeded on the basis that "since it (the Indian subsidiary) was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary" ***[This is an error in the nature of error of misconception of facts by the Tribunal]***

- The special bench "had taken the facts in the case of Ericsson case and on the presumption that those facts were common the case of Nokia as well and the legal questions in the appeals of Nokia were decided therefore the factual inaccuracy has crept in the fact findings of the Tribunal". ***[This is an error in the nature of error of misconception of facts by the Tribunal]***

- The Special bench erred in not appreciating "that the CIT(A) had proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability" and that "the CIT(A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian subsidiary did not occur at arm's length" but it was argued before Their Lordships that "there was no basis for drawing such inference and at the time of arguments, the learned ASG conceded that there was no evidence to support that losses were absorbed by the Indian company" ***[These are errors in the nature of error of not appreciating incorrectness of the findings of the CIT(A) which, as learned ASG agrees, are not based on any material]***

- The conclusion arrived at by the special bench "was erroneous as it was based on various factual errors which has crept in the orders of the lower authorities *(emphasis supplied by me now)*"……..and "the factual errors of the orders of the AO were specifically pointed out in the submissions to the CIT (A) and specific grounds were also taken before him *(emphasis supplied by me now)* which are as under:-

(i) The Indian subsidiary was executing contracts on behalf of the appellant through its employees.

(ii) All the contracts with the operators were signed in India.

(iii) The employees of Indian Office (LO) were compensated by some other entity.

(iv) From 1996 onwards all the expenses of Indian office were shifted to the Indian subsidiary.

(v) The employees of the Indian office were responsible for execution of the contracts with operators.

(vi) No compensation was paid to IC for marketing and support services prior to 1997.

(vii) PSC was set up in India to supervise the supply contract with TATA.

(viii) Certificate of acceptance was signed by Indian subsidiary on behalf of the appellant.

[This is an error in the nature of error of proceeding on the basis of certain incorrect factual findings of the AO, which were challenged before the CIT(A), but apparently not disposed of]

<u>The Questions requiring adjudication of/ determination by this Special Bench:</u>

11. Quite clearly, apart from an error of omission in not dealing with quantification of the PE profit attribution- which essentially proceeds on the basis that there were some arguments on that aspects before the Special Bench, the mistakes pointed out by Hon'ble High Court are (i) that the Special Bench proceeded on the basis that "since it (the Indian subsidiary) was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary" which "learned ASG also conceded that it was not correct"; (ii) that the Special Bench mixed up facts of Ericson's case with the case of the case assessee and resultantly inaccuracy crept in; (iii) that the conclusions arrived at by the Special Bench were based on findings of the CIT(A), in support of which ASG admitted conceded not have any material, to the effect that that the losses of the Indian subsidiary were absorbed by the assessee company; (iv) that the Special Bench erred in not appreciating "that the CIT(A) had proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability" and that "the CIT(A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian subsidiary did not occur at arm's length" but it was argued before Their Lordships that "there was no basis for drawing such inference and at the time of arguments, and, finally (v) that the conclusion arrived at by the special bench

"was erroneous as it was based on various factual errors which has crept in the orders of the lower authorities" set out in above. What has been thus pointed out by Their Lordships are errors in reasoning adopted by the Special Bench, and the fact that, in the light of these errors, the conclusions arrived at by the Special Bench are required to be revisited. However, by no stretch of logic, these observations can be construed as a decision on merits, in favour of the assessee, and reversal of the findings of the Special Bench. To this extent, perceptions of the learned counsel for the assessee, on the implications of Hon'ble High Court's judgment is not correct. Except for the mistakes so specifically pointed out by Their Lordships, all the issues are left open for adjudication and determination. It is in the backdrop of this factual scenario that the questions to be decided by this bench, so far as the existence of the permanent establishment and profit attribution thereto is concerned, are as follows:

(a) Whether, on the facts and in the circumstances of this case, the subsidiary company of the assessee, namely Nokia India Pvt Ltd (NIPL), would constitute business connection or permanent establishment of the assessee company, i.e. Nokia OY, Finland;

(b) In the event of NIPL being held to be a PE of the assessee company, whether any profit could indeed be attributed to the PE on account of "signing, networking, planning and negotiation of offshore supply contracts in India"; and

(c) In case NIPL is held to be PE of the assessee company and in case the work in the nature of "signing, networking, planning and negotiation of offshore supply contracts in India" can be said to have any profit attribution, what will be quantum of profits which can be attributes to these activities.

My analysis of the case:

12. The first issue requiring adjudication by this bench is whether or not Indian subsidiary company of the assessee company, i.e. Nokia India Pvt Ltd, constitutes a permanent establishment of the assessee company. As we take this call, we have to bear in mind (i) the legal position, as set out by Hon'ble High Court so unambiguously, that merely because the NIPL a wholly owned subsidiary, it is wrong to assume that the assessee would have direct and complete control over the activities of this subsidiary and that there is no evidence to the effect that the losses of the Indian subsidiary were met by the assessee company; and (ii) the factual position that there is no evidence to suggest "the losses of the Indian subsidiary were absorbed by the assessee company". I must also bear in mind the factual errors in the order of the Assessing Officer, which were also pointed out in the grounds of appeal before the CIT(A), and not to base my conclusions on such findings.

13. As I proceed to deal with this aspect of the matter, I must deal with a preliminary issue raised by the learned counsel. He submits that this question regarding existence of PE is to be determined in the light of certain observations made by the Hon'ble High Court. All the findings in the orders of the authorities below, as indeed whole of the order of the Tribunal in the first round, stand disapproved, and, therefore, unless revenue brings out some new

material in support of the contention that the assessee had a PE in India, the assessee company cannot be said to have a PE in India. He, nevertheless, accepts that there is no finding by Hon'ble High Court on the existence of the dependent agency permanent establishment, and that is an aspect, therefore, which may be adjudicated upon by the Tribunal now. Learned counsel's basic plea thus is that so far as the issue of existence of permanent establishment under the basic rule is concerned, Hon'ble High Court has comprehensively decided the issue in favour of the assessee, and all that can, therefore, be examined is whether or not the assessee company had a DAPE (dependent agent permanent establishment) by way of the Indian subsidiary (i.e. Nokia India Pvt Ltd).

14. I do not share the perceptions of the learned counsel. Undoubtedly, Hon'ble Delhi High Court has pointed out an error of omission (i.e. not dealing with quantification of PE profit attribution), certain errors of misconception of facts (i.e. mixing up facts of Ericson with the facts of this case, proceeding on the basis that since NIPL was a wholly owned subsidiary, the assessee will have direct and complete control over the subsidiary and proceeding on the basis that there was evidence to support the plea that losses of the Indian subsidiary were absorbed by the assessee company) and the error of reaching erroneous conclusions on the basis of factual errors in the orders of the AO which were duly pointed out to the CIT(A). Yet, none of these errors, either on standalone basis or taken together, cannot lead us to the conclusion that the finding of the earlier Special Bench is to be reversed. The errors so pointed out by Their Lordships do lead to the conclusion that, based on the material on record, findings of the Tribunal could not be sustained, but then there is a difference, and a vital difference at that, in the findings of the Tribunal not being sustained and the findings of the Tribunal being reversed. Take, for example, Their Lordships' observation that "**In the opinion of the ITAT, since it** *(the Indian subsidiary)* **was a wholly owned subsidiary, the assessee would have direct and complete control over the activities of this subsidiary**"- as assertion which learned ASG conceded to be incorrect. The cause and effect relationship mentioned by Their Lordships is between a company being "wholly owned subsidiary" and the assumption that "the assessee would have complete control over the activities of the subsidiary". What Their Lordships have observed about incorrectness of this approach is certainly valid on plain first principles, apart from being binding law on the subject, and the same principle is well enshrined in Article 5(8) of the applicable Indo Finnish tax treaty which states that "**The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company or a permanent establishment of the other**". All that the principle recognized by Their Lordships, which is also well enshrined in Article 5(8), means is that a subsidiary cannot be said to be PE of the foreign company solely on the ground that it is controlled by a company resident of the other contracting state. The wordings employed in the observations of Their Lordships are different but implications are the same, because once it is concluded that the foreign company has direct and complete control over the activities of a subsidiary, essentially that subsidiary ends up being treated as a permanent establishment of the foreign company on the ground of its being a "wholly owned subsidiary". However, that does not mean that a subsidiary of the assessee company cannot be held to be its PE at all. It is only elementary that there can be, and there are, situations in which a subsidiary can be treated as PE of a company fiscally

domiciled in the treaty partner jurisdiction. Clearly, therefore, while there is no bar on the subsidiary of a foreign company being treated as a PE of the parent company, mere existence of the subsidiary of a company resident in the treaty partner country would not imply that such a foreign enterprise has a PE in India. Going even by the OECD Commentary *(which has been adopted in the UN Commentary as well)*, with which I have some issues on this point and I will discuss that in detail a little later, there can be situations in which a subsidiary can be a permanent establishment of the parent company, and even *vice versa*. The following extracts from the current OECD Commentary will throw light on the same:

> *115. It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company.*
>
> *116. A parent company may, however, be found, under the rules of paragraph 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 10 to 19 above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of the Article (see for instance, the example in paragraph 15 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the conditions of that paragraph are met (see paragraphs 82 to 99 above), unless paragraph 6 of the Article applies.*
>
> *117. The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal (see paragraphs 10 to 19 above) and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article (see paragraphs 82 to 99 above). The determination of the existence of a permanent establishment under the rules of paragraph 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.*
>
> *118. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company's own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through*

> *that location: clearly, a company that merely purchases parts produced or services supplied by another company in a different country would not have a permanent establishment because of that, even though it may benefit from the manufacturing of these parts or the supplying of these services.*

15. It will, therefore, be wholly inappropriate to proceed on the basis that just because Their Lordships have observed that the Special Bench was incorrect in proceeding on the basis that merely because the NIPL was a wholly owned subsidiary, the assessee had direct and complete control over the activities of subsidiary, we have to now proceed on the basis that NIPL cannot be a PE of the assessee company. The direct control over subsidiary simply by the virtue of ownership is just one of the aspects of the matter, but there can be a direct control over subsidiary on account of several other factors as well. Those aspects of the matter, in my humble understanding, are open issues and this Tribunal is duty bound to deal with those aspects of the matter, to the extent clearly discernible from material on record, as well.

16. Similar is the position with respect to the mistake on account of mixing up the facts of this case with the facts of Ericson's case and proceeding on the basis that the assessee company absorbed the losses of the Indian subsidiary. All that these mistakes require is that while proceeding to draw our conclusions, we must remain confined to our facts, without mixing up with the facts of Ericson's case- or, for that purpose, the case of any other assessee, and that while deciding whether or not Nokia India Pvt Ltd is a PE of the assessee company, we must not proceed on the basis that the losses of Nokia India Pvt Ltd are absorbed by the assessee company. That does not, however, mean that Nokia India Pvt Ltd cannot now be treated as PE of the assessee company when it can be so established on its own facts and irrespective of the fact as to whether or not the looses of Nokia India Pvt Ltd were absorbed by the assessee company. On the same lines, while it is indeed held by Hon'ble Delhi High Court that the Special Bench did err in not appreciating that "that the CIT(A) had proceeded on the basis that Indian subsidiary incurred huge loss and the parent assessee was aware of its profitability" and that "the CIT(A) also observed that since NPL was 100% subsidiary and the assessee had wide experience in this area of business, it is logical that a transaction between the assessee and the Indian subsidiary did not occur at arm's length" and it was argued before Their Lordships that "there was no basis for drawing such inference", this finding cannot come in the way of this Tribunal's holding that there the Nokia India Pvt Ltd was a PE of the assessee company, or even the transactions not being arm's length transactions, as long as it can be so held without any influence of the holding-subsidiary relationship and rich experience of the assessee company in its line of business. The situation with regard to the conclusions of the Tribunal being vitiated by incorrectness of findings in the orders of the authorities below is no different either. No doubt, as pointed by Their Lordships, the conclusions arrived by the Tribunal "was erroneous as it was based on various factual errors which has crept in the orders of the lower authorities"……..and "the factual errors of the orders of the AO were specifically pointed out in the submissions to the CIT (A) and specific grounds were also taken before him", but then that's not the end of the road for the case of the Revenue. Their Lordships noted that "the order of the Tribunal is based on many factual errors" but then referred the matter back to the Tribunal "for fresh consideration on the issues as to whether the subsidiary of the assessee …….is Permanent Establishment…". What essentially implies is that the Tribunal has to take a fresh call on this question, and, while doing so, the conclusions of the Tribunal must not be vitiated by the

factual mistakes that it had committed in the first round of proceedings. In the light of the discussions above, it is also clear that typically subsidiary companies, by default, do not constitute permanent establishments of the parent company though but then in a situation in which facts of a case warrant or justify such a conclusion, there is no bar in treating an Indian subsidiary as PE of the foreign company in India. That is the reason as to why, in a situation in which the foreign parent company and the Indian subsidiary company are operating in India simultaneously, any finding about the Indian subsidiary constituting a PE of the foreign company essentially requires a careful analysis about operations of both the companies in India.

17. It is in the light of the above discussions that I have to take my call on the question as to whether the assessee company could be said to have a business connection in India so as to bring it income within deeming fiction of Section 9(1)(i) of the Income Tax Act, 1961, and whether the assessee company can be said to have a PE in India, in the form of its subsidiary company- Nokia India Pvt Ltd.

18. Let me now turn to the case of the Revenue so far as existence of a business connection and existence of the PE is concerned. The stand of the Assessing Officer, as noted at page 24 of the assessment order for the assessment year 1997-98, is that "**the Indian company is economically dependent on the foreign company**" inasmuch as "**all it's shares are held by the Nokia Telecommunications OY <u>and</u>** *(emphasis, by underlining, supplied by me)* **all its receipts from contracts are executed by it for the supplies made Nokia Telecommunications OY**" as also the fact that "**there is total control over the management of affairs of Nokia Telecommunications Pvt Ltd since it's a 100% subsidiary <u>and further</u>** *(emphasis supplied by me)* **the foreign company is taking guarantee on behalf of Indian company that they** *(the foreign company)* **will see to it that contracts** *(entered into by the Indian subsidiary company)* **are properly executed**". The Assessing Officer also noted that awarding of technical support services contracts, in respect of the equipment supplied by the assessee company, involved a specific undertaking to the end customer to the effect that "as long as any part of the commitments under the technical support agreement remain outstanding, we will continuously and diligently monitor business affairs of Nokia India with the aim of ensuring that the company at all times is in a position to meet its commitments to you" and that "as long as any part of technical support agreement are not performed, we shall not dispose of our ownership of Nokia India Pvt Ltd below 51% without your prior written permission". He was of the view that in the light of this position, "the assessee company has a permanent establishment in India in the form of its Indian subsidiary, which is a dependent agent permanent establishment". It is on the basis of this reasoning that the Assessing Officer, in the immediately succeeding paragraph, concludes that "**the Indian company is nothing but an extension of the foreign company**", that "**the Indian company was providing the marketing support and coordination on behalf of the foreign company**" and that these factors, along-with other facts of the case, make it clear "**that the incorporation of Indian company was a veil to avoid the taxability of the foreign company on profits earned through the supplies made by the assessee company**". Essentially, therefore, unmistakable pointer of the Assessing Officer is that the Indian subsidiary company of the assessee, because of the activities carried out by the subsidiary and the manner in which these activities are carried out, constitutes permanent establishment of the assessee company. Yet, he has stated, clearly unmindful of the correct

implications of the expression ‘dependent agent permanent establishment’, “**the assessee company has a permanent establishment in India in the form of its Indian subsidiary, which is a dependent agent permanent establishment”**. There is not even whisper of a reasoning in support of any of the ingredient of the DAPE under article 5(5). The existence of a DAPE, under Article 5(5), comes into play when a person “**has, and habitually exercises in that state (i.e. India, in this case), an authority to conclude contracts in the name of the enterprise (i.e. the assessee company**)” in certain circumstances, **or** when such a person “**has no such authority but habitually maintains in the first mentioned state (i.e. India, in this case) a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of that enterprise (i.e. the assessee company**)”. No case has been made out for satisfaction of these conditions, and, therefore, it is not even case of the Assessing Officer, in terms of the legal connotations of ‘dependent agent permanent establishment”, that the Indian subsidiary constituted PE of the assessee company. As a matter of fact, given the reasoning adopted by the Assessing Officer and the broad thrust of his case, the natural corollary of this reasoning, when held to be correct, is that the Indian subsidiary is held to be a permanent establishment of the assessee company under the basic rule on interdependence and interplay of activities of the assessee company and its Indian subsidiary. This aspect is even more clear from the order of the CIT(A), whose powers are coterminous with that of the Assessing Officer, which, *inter alia*, states as follows:

> **The assessee had also a wholly owned subsidiary in India. It has been pointed out earlier that representation was made to the Indian operators that the assessee would to ensure that the installation contract was carried out fully by the IC, and the assessee would fully support the IC in discharge of its obligations under the contract. Not only that it was also represented that the assessee will not dilute its activity below 51% in the IC without the written permission of the Indian operator. In view of these representations and the counter undertakings given by the assessee and the IC, it cannot be said that the IC acted independently in discharge of its obligations under the contracts. ……………….. In the context of these facts, it will be difficult to hold that the assessee and the IC acted independently in so far as their businesses are concerned and it will more appropriate to hold that the IC merely acted at the instructions of the assessee in respect of installation and marketing contracts. …………... We have also seen that the appellant himself has taken up the responsibility on behalf of the subsidiary company and has gone to the extent of holding out that its equity will not be diluted below 51% till installation contract is completed, except with written permission of the Indian operator. This strengthens the view that the assertions of the assessee in the matter are not correct. Accordingly, it is held that the ld. AO was right in holding that the appellant had a PE in India through the office of the IC.**

19. The findings of the CIT(A), which are called into question in appeal before us, adopt and approve the same reasoning as was adopted by the Assessing Officer and come to the conclusion that the assessee company had a PE in India through the office of the Indian subsidiary company as the Indian subsidiary was acting, not because of the ownership of the Indian subsidiary company but because of the nature of, and manner in which, business activities are carried out by the assessee company and the Indian subsidiary company.

20. Verbosity of the assessment order apart, there can hardly be any doubt about underlying thrust of the assessment order. There is no mention about satisfaction of the conditions of the DAPE under article 5(5) and yet the Assessing Officer has referred to the dependent agent at several places, even though, as I have noted earlier in the order, the unmistakable thrust of the assessment order is that the Indian subsidiary, because of the nature of, and the manner in which, business activities of the assessee company and its subsidiary are carried out, the PE is established. Such a reference to the PE does not refer to, and must not be construed as referring to, the existence of PE under the article 5(5) which relates to certain fact situation, with respect authority to conclude contracts, since it was not even the case of the Assessing Officer than such a situation existed on the facts of this case. I cannot be so pedantic in my approach that just because the Assessing Officer has used the expression 'DAPE', maybe incorrectly, I confine myself to article 5(5), and decline to deal with natural corollaries of the reasoning adopted by the Assessing Officer. In any event, the order passed by the Assessing Officer stands merged in the CIT(A)'s order, and, in the absence of any specific reference to article 5(5), such a specific reference need be inferred. The unmistakable thrust of the case of the Assessing Officer is that the Indian subsidiary company, on account of the nature of business activities of the Indian subsidiary, and the manner in which these business activities are carried out, constitutes a PE, and we must deal with that. Let us not forget that the point of time when the impugned assessment order was framed was the point of time when Indian economy had just opened its doors to the global businesses and international taxation, as a field of study in India as also as a specialized area of work in the field offices of income tax department, was still in its infancy. It was much later that a separate wing was established for dealing with international taxation matters. Given these ground realities, it would perhaps only be appropriate not to be pedantic and hyper technical in our approach and concentrate on the substance of the findings of the Assessing Officer and natural corollaries thereof.

21. The first question that I must, however, deal with is whether the assessee can be said to have a business connection in India.

22. The expression 'business connection' is not a defined expression under the statute but observations made by Hon'ble Supreme Court's landmark judgment in the case of **CIT Vs R D Agarwal & Co [(1965) 56 ITR 20 (SC)]** give ample guidance about its connotations:

> **.........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 means something more than "business". A business connection ....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 <u>it may merely be a relation between the business of the non-resident and the</u>**

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 a real or intimate connection through which income must accrue or arise, whether directly or indirectly, to the non resident…….

[Emphasis, by underlining, supplied by me]

23. Hon'ble AP High Court's judgment in the case of **GVK Industries Vs ITO [(1997) 228 ITR 564 (AP)]**, which stands approved by Hon'ble Supreme Court in the judgment reported as **GVK Industries Vs ITO [(2015) 371 ITR 453 (SC)],** has explained the legal position with respect to the connotations of 'business connection' as follows:

(i) Whether, there is a business connection between an Indian company and a non-resident (company) is a mixed question of fact and law which has to be determined on the facts and circumstances of each case;

(ii) The expression 'business connection' is too wide to admit of any precise definition; however, it has some well-known attributes;

(iii) The essence of 'business connection' is existence of close, real, intimate relationship and commonness of interest between the NRC and the Indian person;

(iv) Where there is control of management or finances or substantial holding of equity shares or sharing of profits by the NRC of the Indian person, the requirement of principle (iii) is fulfilled;

(v) To constitute 'business connection', there must be continuity of activity or operation of the NRC with the Indian party and that a stray or isolated transaction is not enough to establish a business connection

24. Let me, in the light of this legal position, turn to the facts of this case. There is no dispute that the IC (i.e. Indian subsidiary company/ NIPL) was providing administrative support to the visiting expatriate employees of the assessee company. In the course of recording of statement of the Manging Director of IC, a specific question was put to him and the question was "what all facilities were provided by Nokia Ltd to the expatriates coming for marketing and signing the contracts on behalf of Nokia Finland" in response to which it was stated that "administrative support like office support, cars, telephone etc are provided by Nokia Ltd". As stated in the statement of facts before the CIT(A), "though it was stated that, during the course of assessment proceedings, that service agreement was effective from January 1, 1997, prior to which marketing was done by Nokia Finland directly, we stand corrected that an agreement (dated April 19, 1996) did exist for the provision of services before 1997 and the payment of Rs 7,16,00,000 was made by Nokia Finland to Nokia Limited pursuant to invoice no. 61084 dated December 16, 1996". It is also stand of the assessee that the IC was compensated, on arm's length basis, for the services rendered by the IC to the customers of the assessee. It is difficult, for the detailed reasons that I will set out, to take these arrangements at face value and as arm's length arrangements, including in the light

of the statement of IC's Managing Director, which was recorded on 14th February 2000, extracts from which are reproduced below:

> **Q 2: As per your agreement with Nokia Telecommunications OY and the customers, Nokia Finland has to give support locally. How is it carried out?**
>
> **Ans: We carry out by using the human resources and the facilities available in India.**
>
> **Q 3: Do you charge your parent company for such services?**
>
> **Ans: I am not aware of this.**
>
> **……………………..**
>
> **Q.14: What were you charging for administrative support provided by your company to Nokia Finland?**
>
> **Ans: Before 1997, nothing was charged. After 1997, it was charged on the basis of cost plus 5% of the cost.**

25. When I look at the agreement dated 19th April 1996, I find that, under article III thereof, the said agreement provides for consideration for services rendered by the IC "the marketing and administration costs plus a margin of 5%", that the IC will invoice the assessee company "on a quarterly basis for services rendered during such period" and that "such invoices shall be payable not later than 30 days after the date thereof". Yet, even going by the admission made by the assessee in the statement of facts extracted in the preceding paragraph, first bill was raised on 16th December 1996 whereas, under article I of the said agreement, "the agreement shall be deemed to be effective as from 1.1.1996 and will continue in force until 31.12.1996". No invoice is raised for the quarter ending 31st March 1996, no invoice is raised for the quarter ending 30th June 1996 and no invoice is raised even for the quarter ending 30th September 1996 and yet, without waiting for the 31st December 1996, an invoice is raised on 16th December 1996. All this shows that though there is an agreement on record, since there are no contemporaneous actions in furtherance of this agreement, it inspires little confidence as an ordinary commercial agreement. It is also interesting to note that while in the recitals the agreement states that "the NTPL has valuable knowledge, expertise and experience and possess extensive information and has, at its disposal, the necessary infrastructure and sufficient skilled personnel to provide services in the nature of consultancy and advisory services as well as commercial and industrial information to NYC OY", all that the company has is less than one year legal existence (the company was incorporated on 23th May 1995 and the agreement was claimed to have been signed on 19th April 1996) at its disposal when this agreement was signed, and the entire expertise, experience and knowledge is predominantly dependent on the expatriate employees of the assessee company working for this Indian subsidiary at the operational level as also at the top management level. The agreement was signed, on behalf of the subsidiary, by the then Managing Director of the Indian company who was also an employee of the assessee company and wearing two different hats at the same point of time, one as Country Manager-India of the assessee company, and the other, as Managing Director of the IC. The persons actually rendering these expert services were also the employees of the assessee company, though wearing a different cap while rendering these services on behalf of the IC. All this

adequately demonstrates that the contents of the agreement cannot be taken at face value, and the role of these persons, who were predominantly employees of the assessee company on secondment or otherwise deeply associated with the assessee company, working through the IC was the same as it would have been even if these persons were to directly work in their normal capacity as representatives of the assessee company. The agreement is more of a device which brings Indian IC into picture to artificially block creation of PE if the realities of actual operations was not to be vitiated by these projections and devices. It is also interesting to note that for a mark up of just 5%, invoicing is being done at the year end practically forcing the assessee to wait for even upto an year to get the reimbursements at a margin of 5% which was much less than time value of money in a situation in which prevailing interest rates in India were in well into double digits in the safest forms. In simple words, if IC was to spend lets say Rs 2 crore in the first quarter, all it had to get was Rs 2.05 crores on a date later than year end whereas interest even in the fixed deposits, assumed @ 10%, at that point of time would have converted this 2 crores into Rs 2.15 crores in those nine months. The arrangements between the assessee company and the IC were, for these reasons alone, anything but commercial arrangements in the normal course of business of two independent enterprises. That apart, it is difficult to believe that Managing Director of a company, in the course of a statement recorded on oath, will make a false or incorrect statement and claim that nothing was charged in pre-1997 period. Proceedings, however, on the basis that the assessee had indeed made payments for rendition of these services, and even as we will discuss arm's length nature of these payments a little later, it is certainly beyond doubt that the Managing Director, at the point of time when his statement was being recorded, was not even aware whether or not the IC was being paid any consideration for rendition of support services. That would mean that irrespective of whether or not the payment was made for such support services, the money consideration for such services was certainly not essence of the arrangement. When a subsidiary in rendering services to its parent company, without its own business interests as the essence of arrangement to render the services, this selfless rendition of services, by itself, leaves nothing to imagination. The commercial entities inherently work for commercial interests- if not its own, for the commercial interests of someone else closely associated with such entities, as, for example, parent companies. In view of this analysis, in my considered, the subsidiary can be reasonably inferred to be acting for the benefit of the parent company. If the money consideration for these services was to be essence of the arrangements, someone sitting at the helm of affairs would have at least known about the fact of, if not quantum of, money consideration. These arrangements of the assessee with its Indian subsidiary were on a continuous basis and integral to its main business interests in India. It is also important to note that the assessee company was selling high value complex infrastructure project and in all the cases of its sale of these projects, the erection contract and after sale service contract was awarded to IC. As to the nature of these business transactions, I may refer to the following statement made by the Managing Director of the assessee company, on oath, on 14th February 2000:

> **Q 8 During the year 1995 and 1996, most of the contracts were signed. How marketing was carried out by Indian company?**
>
> **Ans: These are very complex infrastructure projects. There is a group of very specialized people who do the marketing and sales, contract negotiations and trade finance, if required. At the same time, local services such as contract**

> **management, roll out services (deployment) and system integration (if required) are marketed and sold by local office.**

26. I have also noticed that though an impression is given that the contracts awarded to the IC by Nokia's customers are given on independent principal to principal basis but a little probe in the facts of the case would clearly show that these are not independent contracts inasmuch as the assessee company has given significant and decisive representations on the basis of which the contacts are awarded to the IC. While on this aspect of the matter, I may once again refer to the letter dated 15th June 1996 whereby the assessee company has confirmed to Tata Communications Ltd as follows:

> **This is to confirm that we, Nokia Telecommunications OY, a company duly registered and existing under the laws of the Republic of Finland, are fully aware that you have awarded a contract to Nokia Telecommunications Pvt Ltd (Nokia India) for installation, testing and commissioning of GSM Digital Cellular Mobile Telephone Network of Tata Telecommunications Ltd and for the performance of various other services and activities in connection therewith (the service contract).**
>
> **We, the undersigned company, hereby guarantee in your favour the due and timely discharge and performance, in accordance with the said services contract, of all the obligations and liabilities of Nokia India arising from and pursuant to the said services contract.**
>
> **This guarantee constitutes an independent and legally valid undertaking in your favour. We represent to you that it is duly approved by the Directors, Nokia Telecommunications OY**

27. The services being rendered by the IC to the Indian customers are on the basis of assurances given by the assessee company and it is on the basis of the services rendered by the IC to the Indian customers that the assessee company is selling its infrastructure projects in India. As I have noted earlier also, the assessee company has also given a specific undertaking to the customers to the effect that "**as long as any part of the commitments under the technical support agreement remain outstanding, we will continuously and diligently monitor business affairs of Nokia India with the aim of ensuring that the company at all times is in a position to meet its commitments to you**" and that "**as long as any part of technical support agreement are not performed, we shall not dispose of our ownership of Nokia India Pvt Ltd below 51% without your prior written permission**". On a realistic note, the role played by these undertakings and arrangements cannot be ignored in the association of the IC with the customers of the assessee company. One cannot be so naïve so as to ignore the role played by the assessee company is ensuring business for its subsidiary and the role played by the subsidiary in furtherance of the business interests of the assessee company. These two entities, even though hypothetically and legally independent of each other, have carried out their respective business activities in tandem with each other. On these facts, the work done by the IC cannot be viewed on a standalone basis. It has to be little more than coincidence that all the India based customers of the assessee company have awarded the erection and after sales service contracts to its Indian subsidiary. As a matter of fact, it is not even in dispute that the assessee company plays the decisive role in deciding as to who should be awarded the erection contract. In the submissions dated 14th February 2000,

the assessee has accepted that position by stating, at page 5- paragraph 7(1), that "**the clause in agreements** *(for sale of equipment by the assessee company)* **merely provides for installation to be done by person approved by the supplier of the equipment** *(i.e. the assessee company)*". Essentially, therefore, none could have been given the installation contract without the blessings of the assessee company. One also has to bear in mind the fact that control by the assessee company was essence of the approval as evident from the fact that not only the assessee had given performance guarantee about the work performed by the IC but also an undertaking to the end customer to assure him that even ownership control will not be diluted during the currency of agreement. No reasonable person with elementary understanding of trade and commerce cannot be so naïve as to actually buy the theory that the contacts between the IC and the end customers were independent commercial contracts with no involvement of the assessee company. The relationship between the assessee company and its Indian subsidiary is thus clear and vital. The assessee company is able to sell its infrastructure equipment in India as the erection, after sales, roll out services are rendered by its Indian subsidiary and the Indian subsidiary is able to get these contracts on the basis of assurances given by the assessee company not only with respect to the quality of work done by the Indian subsidiary but also on the basis of a specific assurance that the ownership in India subsidiary, during the currency of arrangements of the assessee company's agreements with the Indian subsidiary, will not be diluted below 51%. All this, at the minimum, shows the interconnection and interdependence of the assessee company and its Indian subsidiary so far as business operations of the assessee company in India are concerned.

28. In my considered view, therefore, the assessee did indeed have a business connection in India by way of its Indian subsidiary which was acting in a manner which was, at the minimum, as much, even if not more, for the furtherance of the business interests of the assessee company in India as much, if not more, for its own economic and business interests. As I hold so, I must also point out that just because the manner in which the assessee company has acted is in its own interests, even if we hypothetically assume so, it does not cease to be a business connection for its parent company because a business connection, to quote the words of Hon'ble Supreme Court in R D Agarwal's case *(supra),* "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" of the non-resident. That is precisely what the IC, at the minimum, does in the present case. I donot share the perception of the majority that **"the marketing activities and installation contract undertaken by NIPL has been on principal to principal basis; and in the case of the former agreement between assessee and NIPL the payment has been made to NIPL on cost plus basis which has not been disturbed; and in the later agreement there**….*(are)* **independent contracts with Indian customers which has nothing to do with the assessee"**. These contracts, in my opinion, have so much to do with the assessee that these contracts would not have been possible but for the indulgences shown by the assessee and these contracts cannot be viewed as independent contracts between the IC and the Indian customers of the assessee company, in isolation with the assessee company. The sale agreements clearly provide that the installation of equipment is to be done by a person approved by the assessee company, and, as I have noted earlier, it is certainly little more than coincidence that all the installation contracts have been awarded to the IC. As regards the services contracts between the assessee company and the IC, things are no better either. As I have discussed earlier, there is no contemporaneous evidence in support of pre 1997 contract for services, there are conflicting statements made by the assessee, and that, in any case, the contract dated 19th

April 1996 cannot be justified as a commercial contract in *bonafide* interests of the IC in ordinary course of business. As for the contracts between Indian customers and the IC, the assessee company has, on record and by way of specific undertakings, played a crucial role for these contracts being awarded to the IC vitiating the character of these contracts as independent contracts between the IC and the assessee company's Indian customers which have, to quote the words of the majority, "nothing to do with the assessee". As for the profit earned by the IC on these contracts having been offered to tax anyway, on which so much of emphasis has been placed by the learned counsel, that aspect of the matter is not relevant at this stage for determining the existence of business connection.

29. Let me now briefly touch upon Hon'ble jurisdictional High Court's judgment in the case of **Nortel Network India International Vs Director of Income Tax [(2016) 386 ITR 353 (Del)].** Incidentally, this is a case primarily on profit attributable to the business connection rather than existence of business connection itself, and nothing much therefore really turns on this case on the question that I am addressing at present, but let me deal with it nevertheless.

30. In Nortel's case, the factual background, as noted by Their Lordships, was this. The assessee before Their Lordship was a US based company (Nortel USA, in short), which was a step down subsidiary of Nortel Network Limited Canada (Nortel Canada, in short). Nortel Canada, through a network of companies based in Luxemburg, the Netherlands and Mauritius, had a subsidiary in India by the name of Nortel Network India Ltd (Nortel India, in short). Nortel Canada also had a liaison office in India. On 8th June 2002, Nortel India negotiated three separate contracts with Reliance India Ltd (RIL, in short) – namely Optical Equipment Contracts, Optical Services Contract and Software Contract, and, on the same date- with Nortel Canada and RIL being parties to the arrangement, assigned the equipment contract to the Nortel USA. Nortel Canada guaranteed the performance of equipment contract by Nortel USA. On these facts, the case of the Assessing Officer was that Nortel USA was a shadow company of Nortel Canada and was inserted as an intermediary only to avoid taxes, and that "in substance, the contracts were performed by Nortel Canada along with its LO and Nortel India, who acted in unison to identify, negotiate, appraise, secure, execute, manufacture, supply, install, commission and provide warranty and after sales service in respect of the Optical Fibre project of Reliance". Rejecting the financial results filed by the assessee, which were unaudited, the Assessing Officer proceeded to estimate the profits of the assessee company on the basis of book results shown by the Nortel Canada. When matter travelled in appeal before the CIT(A), it was held, as noted by Their Lordships, that " (a) that the Assessee was assigned the contract for supply of hardware to Reliance Infocom days after its incorporation; (b) this is the only business that appellant had done during the relevant period under consideration; (c) the Assessee did not have any financial or technical capability of its own; (d) the equipment supplied was manufactured by Nortel Canada and Nortel Ireland and shipped directly from Canada/Ireland; (e) that the Assessee had supplied the equipment at approximately half its purchase price, thus, incurring huge trading loss in the transaction". The CIT(A) held that the transactions were to be viewed as a whole and not merely in the form of the agreement. On the basis of the aforesaid findings, the CIT(A) upheld the conclusion of the AO that the assessee was a paper company incorporated only with a motive to evade income tax liability on the income arising out of the supply contract in India and, therefore, Nortel Canada and the assessee were to be considered as a single entity. The CIT(A) further rejected the assessee's contention that it did not have a business

connection in India". In appeal, a division bench of this Tribunal "rejected the assessee's contention that the sale of equipment was completed overseas and the installation was done under a separate contract" and held that "the assessee through Nortel India and LO approached the customer, negotiated the contract, bagged the contract, supplied equipment, installed the same, undertook acceptance test after which the system was accepted" and that "The equipment remained in the virtual possession of Nortel Group till such time the equipment is set up and acceptance test is done." The income in the hands of Nortel USA was thus attributed on the basis of profitability of the Nortel Canada.

31. It was in this backdrop that Hon'ble Delhi High Court held that Nortel USA did not have PE in India and the profit on sale of equipment by Nortel USA to RIL could not be brought to tax in India. Interestingly, however, it was not even the case of the income tax authorities that Nortel India was acting as an extension of Nortel USA who was assessee in this case. That fact takes it out of comparability with the present case. The guarantee for performance of Indian subsidiary was given by Nortel Canada and not the assessee in this case which was Nortel USA. There could not have been, therefore, any consideration attributable to Nortel USA for the services rendered in India by Nortel India. It was on these facts that Hon'ble High Court observed that "if it is accepted that the assessee (i.e. Nortel USA) has received only the consideration for equipment manufactured and delivered overseas, it would be difficult to uphold the view that any part of assessee's income is chargeable to tax under the Act as no portion of the said income could be attributed to operations in India". There can be no quarrel with this proposition, not only in law as this is the binding law for us, but even on the first principles because this is exactly what the unambiguous scheme of the Act is. In sharp contrast with this case before Their Lordships, in which performance guarantee was given by an entity other than the assessee before Their Lordship, the performance guarantee for Indian subsidiary, and commitment not to dilute ownership and control in the Indian subsidiary, is given by the assessee company itself and no separate consideration is received by the assessee for the risk inherent in such a performance guarantee and commitments. Essentially, therefore, reward for this risk, which is wholly undertaken in respect of India operations, is *prima facie* embedded in the sale of equipment by the assessee to the Indian customers. The observations made in Nortel's case, therefore, have no application in the case before us.

32. As regards Explanation 2 and 3, which has been dealt with in paragraph 44 of the order- as reproduced below, it is important to bear in mind the fact that since Explanation 2 only explains what is included in the definition of 'business connection' and is certain not exhaustive, it would be relevant only when the case being made out for existence of business connection hinges on the scope of Explanation 2 alone, which is not the case here. The relevant observations are, nevertheless, reproduced below:

> **44. There is little material on record to hold that Nortel India habitually exercises any authority on behalf of the Assessee or Nortel Canada to conclude contracts on their behalf. There is also no material on record which would indicate that Nortel India maintained any stocks of goods or merchandise in India from which goods were regularly delivered on behalf of the Assessee or Nortel Canada. Thus, by virtue of Explanation 2 read with Explanation 3 to Section 9(1)(i) of the Act, no part of Assessee's income could be brought to tax under the Act. It is only when a non-resident Assessee's income is taxable under**

the Act that the question whether any benefit under the Double Taxation Avoidance Treaty is required to be examined.

33. It is not, and it cannot be, even the contention of the assessee that when conditions of Explanation 2 to Section 9(1)(i) are not fulfilled, there cannot be a business connection, and, rightly so, since the definition of business connection under this statutory provision is only an inclusive, and not exhaustive definition, to cover the dependent agency situations. The wordings of Explanation 2 are on the same lines as DAPE definition in Article 5(5). Therefore, if someone is to proceed on the basis that since the conditions of the Explanation 2 to Section 9(1)(i) are not fulfilled, there cannot be a business connection at all, it will almost be like saying that when there is no DAPE, there cannot be a PE at all. DAPE is only a particular type of the PE, just as much as Explanation 2 definition, which is parallel to Article 5(5) definition is most tax treaties, is a particular type of the business connection. The observations made by Their Lordships in the above paragraph are in the particular context before Their Lordships in a situation in which the general scope of section 9(1)(i) was held to be inadmissible on the particular facts of the case in the immediately preceding paragraph, and these observations cannot be construed as authority for the proposition that when the condition under Explanation 2 to Section 9(1)(i) are not satisfied in any fact situation, even if the provisions of Section 9(1)(i) are satisfied in general, there cannot be a business connection at all.

34. In my humble understanding, therefore, Hon'ble jurisdictional High Court's judgment in the case of Nortel Network *(supra)* cannot be viewed as an authority for the proposition that income embedded in sale of equipment supplied overseas cannot be taxed under the Act under any circumstances, such as in a situation when a part of the consideration paid for such equipment can be reasonably attributed to the risks undertaken by the assessee in India for which he is not separately or adequately rewarded. The sweeping generalizations, as learned counsel seeks to make by relying upon this precedent to draw a proposition which will hold good *de hors* the peculiarities of this case, cannot be permitted. I, therefore, decline to be so overawed by some similarities in Nortel Network's case vis-à-vis the case of this assessee as to, rather than examining this case on its own merits, jump to treat this as a covered matter.

35. As I take this stand, I am reminded of the oft quoted words of Hon'ble Supreme Court, in the case of **Mumbai Kamgar Sabha vs. Abdulbahi Faizullbhai [AIR (1976) SC 1455]**, wherein their Lordships have, in their inimitable and felicitous words observed thus, "**It is trite, going by anglophonic principles that a ruling of a superior Court is binding law. It is not of scriptural sanctity but of ratio-wise luminosity within the edifice of facts where the judicial lamp plays the legal flame. Beyond those walls and de hors the milieu we cannot impart eternal vernal value to the decisions, exalting the precedents into a prison house of bigotry, regardless of the varying circumstances and myriad developments. Realism dictates that a judgment has to be read, subject to the facts directly presented for consideration and not affecting the matters which may lurk in the dark**". It is, therefore, indeed duty of every subordinate judicial forum to apply the rulings of Hon'ble Courts above in such a manner so as to enforce the true legal principles emerging from the same, by putting the words and expression used in the ruling in the right perspective and by taking a holistic legal view of the matter. Viewed thus, I am not inclined to treat this as a matter "squarely covered" by the decision of Hon'ble jurisdictional High Court, in the case of Nortel Network *(supra)*, in favour of the assessee.

36. I am, in the light of the above discussions, of the considered view that the assessee had a business connection in India which brings the assessee within the ambit of taxability in India.

37. The next question that I must address is whether the assessee, on account of its Indian subsidiary i.e. Nokia India Pvt Ltd, can be said to have a PE in India in terms of the provisions applicable Indo Finnish tax treaty.

38. As I proceed to deal with the question as to whether the Indian subsidiary of the assessee company can be treated as its PE and analyse facts of the case in that light, I must first discuss, in some detail, as to under what circumstances can normally a subsidiary be treated as PE of the parent company.

39. 'The Law & Practice of Tax Treaties- An Indian Perspective' by Nilesh Modi (Second Edition, 2014; ISBN-13: 978-81-8473-531-4; at page 447), refers to, what it considers to be, "true test for constitution of a PE" by the subsidiary, in respect of a foreign company, as "whether:

- The business of the foreign enterprise is carried out by its local affiliate; or
- The local affiliate is the *alter ego* of the foreign enterprise or, speaks his masters voice only or, is a mere façade; or
- The foreign enterprise carries on a business in State S, using the premises or personnel, of its local subsidiary".

39. The reference to '*alter ego'* of the foreign enterprise, as is used in Nilesh Modi's book, is more of a colloquial and factual expression rather than a legal term. This term is now also increasingly used in the tax literature worldwide.

40. The expression *alter ego* companies seems to be rather appropriate expression for dealing with a particular type of subsidiaries which constitute PEs of the parent foreign enterprise, and that is how I intend to use it in this analysis. It does refer to the situations in which a subsidiary should be treated as a permanent establishment of its non-resident parent company for the reason that the way and manner in which carries out its business activities, it is nothing but an avtar of, a virtual projection of, or an extension of, its non-resident parent company in the country in which the subsidiary is domiciled.

41. As I make this observation, I cannot but be reminded of the inimitable words of Hon'ble Justice Jagannatha Rao in the case of **CIT Vs Vishakahapatnam Port Trust Vs CIT [(1983) 144 ITR 146 (AP)]** had observed, well ahead of the time, as follows:

> **The words 'permanent establishment' postulates existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which is attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of the another country.**

39. These words of Hon'ble Justice Rao, who later adorned the Hon'ble Supreme Court, are not only always quoted in international tax literature in many parts of the world, Hon'ble

Supreme Court has referred to the same, with approval, in the relatively recent case of **Formulae One World Championship Limited Vs CIT [(2017) 394 ITR 80 (SC)]**. A coordinate special bench of this Tribunal, in the first round of proceedings in this case, has also referred to the virtual projection concept and upheld the existence of the permanent establishment for that reason alone. While the order so passed by the coordinate bench has been remitted to us for fresh adjudication, it has been done so specifically on account of certain factual mistakes creeping in the order and without disturbing the legal principles laid down therein. It is in this backdrop that I believe that virtual projection of the non-resident enterprise into the soil of the source country does result in creation of a permanent establishment as long as it is of enduring and permanent character and it is attributed to a fixed place of business in the source jurisdiction. If such a virtual projection of the foreign enterprise is by way of a subsidiary, which is nothing but an alter ego company of the non-resident parent company, that too would also result in creation of a permanent establishment.

40. Such alter ego companies without any significant and independent activities in their own right have always been, by default, treated as permanent establishments of their parent companies. One ruling, rendered by the Authority for Advance Ruling over two decades back, illustrates this point. In the case of **ABC *In Re* (Application No. P- 8) [(1997) 223 ITR 416 (AAR)]**, the Authority for Advance Ruling, speaking through Justice S Ranganathan- one of the most illustrious former Presidents of this Tribunal, who later adorned high judicial officers including that as a judge of Hon'ble Supreme Court, had observed that it "**is of the opinion that the subsidiary will have to be considered to be a permanent establishment of ABC unless it has significant independent activities on its own or on behalf of persons other than ABC and unconnected with it**". It is to be noted that, in this case, there is no reference to the conclusion of contracts, on behalf of the principal, or to the conditions precedent for invoking article 5(5), and yet the dependent agent, in the form of the subsidiary, has been held to be a PE. I am in most respectful and considered agreement with this approach which essentially leads to the conclusion that when a subsidiary company is merely an *alter ego*, or virtual projection, of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a permanent establishment of the non-resident parent company for that reason alone.

41. While dealing with the *alter ego* companies, Arvid A Skaar's book of "Permanent Establishment- Erosion of a Tax Treaty Principle (South Asian Reprint Edition, 2009; ISBN: 978-81-89960-81-0; at page 544) states, *inter alia*, as follows:

> ***Alter Ego*** companies- extensive business cooperation
>
> For a subsidiary to be constitute a PE, the subsidiary is required the business activity of the parent company. This applies under the basic rule as well as under agency clause and the construction clause.
>
> In US administrative practice, the use of *alter ego* companies, i.e. a subsidiary which merely performs the business of the parent in another country, has been considered …………… The IRS stated, that if "the subsidiary is merely an alter ego of the parent….then a permanent establishment would result under the Convention

42. Referring to the work by Arvid Skaar, Klaus Vogel, in his oft quoted book 'Klaus Vogel on Double Taxation Conventions' (Indian Reprint Edition, 2005; ISBN-13: 978-81-89960-62-9; at page 353) recognizes a situation in which a PE is created by the parent company's assumption of the economic risk of fulfilment of contract by the subsidiary, and, *inter alia*, as follows:

> *(The situation is, however, different)*…..if the parent assumes economic risk of the contract's fulfilment in relation to main customer. In this situation, the parent company and the subsidiary have in fact established a company of which they are partners. This will lead to permanent establishment of the partners if the general pre-conditions are fulfilled

43. This principle also finds recognition in a rather recent judicial precedent in India. In the case of **Ansaldio Energia SPA Vs CIT [(2009) 310 ITR 337 (Mad)]**, Hon'ble Madras High Court had an occasion to deal with a case in which the assessee, a foreign company, was engaged in the business of selling and setting of power plants, and this foreign company ensured the installation contract being given, by the buyer of power plant i.e. Neyveli Lignite Corporation Ltd (NLC) to its Indian subsidiary, namely Ansaldo Services Pvt Ltd (ASLP). It was in this context that Hon'ble High Court had observed as follows:

> 15. Let us look at this contract…………... The assessee, and not NLC, selected ASPL to execute Contract Nos. III & IV. Therefore, **though NLC** *(i.e. the Indian customer)* **entered into Contract** Nos. III and IV **with ASPL** *(i.e. the Indian subsidiary)* **it was only at the instance of the assessee** *(i.e. the foreign enterprise and the parent company)***. ASPL was the assessee's subsidiary company**. **At least as far as this Project was concerned ASPL** *(i.e. the Indian subsidiary)* **is virtually the 'assessee's presence'** *(i.e. virtual presence of the foreign enterprise and the parent company)* **in India. The assessee controlled and managed ASPL for quality ensuring, maintenance of time schedule, quality control, progress of work etc.**

44. It was in this backdrop that Hon'ble Madras High Court upheld the stand of this Tribunal to the effect that the foreign company had a PE in India in the form of its subsidiary company which was assigned, at the instance of the foreign company, the installation work and which constituted "virtually the assessee's presence". That is in effect the same thing as an *alter ego* company. To this extent thus, the concept of *alter ego* companies is not really alien to Indian tax jurisprudence.

45. Undoubtedly, the question as to whether a subsidiary company is an *alter ego* company of its parent company or not, in the sense that its presence constitutes "virtually the presence of the assessee" on standalone basis and in view of the activities being carried out in a dependent relationship with the parent company, it is a question of fact which is to be determined on the facts of each case.

46. On the first principles, taxation will infringe neutrality if source taxation of an enterprise is to depend on the form, and not substance, of its business presence in the source jurisdiction- such as rather than doing a thing itself, getting it done through a subsidiary when the essence of arrangement is a performance guarantee by the non-resident parent enterprise and its undertaking to continue to exercise effective control over the subsidiary.

47. A situation in which the non-resident parent company not only exercises control over the company with a view to control its operational functioning but also to ensure an agreed level of performance, and undertakes to continue to have such controlling equity and control for that purpose till the contractual obligations of the subsidiary vis-à-vis its customers are discharged, presumption about independence between parent and subsidiary company, as envisaged in Article 5(7) of the OECD Model Convention which is exactly the same as Article 5(8) of the UN Model Convention- replicated in Article 5(8) of Indo Finnish tax treaty, are nullified by the peculiar circumstances of such arrangements. While Article 5(8) does state that "**The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself** *(Emphasis supplied by me now)* **constitute either company or a permanent establishment of the other**" but that does not mean that a subsidiary of the assessee company cannot be held to be its PE at all. The underlying rationale of this provision is the presumption about independence of the principal and subsidiary in day to day operations and management of their business as separate entities but once this presumption is demolished, the very *raison d'etre* for exclusion of subsidiaries from being permanent establishments of the overseas parent companies and *vice versa* ceases to hold good. Explaining this point, Arvid A Skaar, in his book "Permanent Establishment- Erosion of a Tax Treaty Principle (South Asian Reprint Edition, 2009; ISBN: 978-81-89960-81-0; at page 540), observes as follows:

> **The treaty based protection of related companies recognizes the legal independence of related companies for tax purposes as a material reality until the opposite is proved** [OECD Comm. 1977 art. 5 no. 39; cf. Debatin, *Systematik* IV, in Korn/Debatin, 1 Doppelbeseteuerung ann. 183 (*looseleaf)*]. **This affects both the constitution of PE, and the allocation of income to a separate entity.**

[Emphasis, by underlining, provided by me]

48. I am in considered agreement with the school of thought that the presumption of independence of the subsidiary holds good only till the contrary is proved, and that is precisely the proposition my analysis in the preceding paragraphs seeks to justify.

49. It may, at this stage, also be noted that while the OECD Model Commentary invariably confine the role of subsidiaries as PE only as a dependent agent- and UN Model Commentary does no better as it simply reproduces and accepts the same, there is no conceptual justification for the same. On this point also, I would like to refer to a very thought provoking observation made by Arvid A Skaar, in his book referred to earlier in this order- at page 541-542, as follows:

> **The conventional position of the OECD based tax treaty doctrine is that a subsidiary PE can only be based on the agency PE clause** *[OECD Comm. 1977 art. 5 no. 39]*. **However, the tax treaties aim at allowing the source state to tax business profits with certain economic allegiance to the country, expressed through the enterprise's PE. This intention must also apply when parent company's business income is earned by intermediation of a subsidiary. Thus from a *de lege ferenda* point of view, PE taxation of the parent company is justified in cases where residence state taxation of subsidiary does not adequately**

attribute taxing jurisdiction to the state. The commentaries to OECD Model treaty donot *de lege lata* give conclusive reasons for the conventional wisdom with regard to this question.

50. The OECD approach has not, however, found favour with the Authority for Advance Ruling in the case of **ABC *In re*** *(supra)* when the Authority opined, and I agree with that approach, that it "**is of the opinion that the subsidiary will have to be considered to be a permanent establishment of ABC unless it has significant independent activities on its own or on behalf of persons other than ABC and unconnected with it**". If the OECD view was to be followed in entirety and in its literal sense, the subsidiary could not have been a PE unless the conditions set out in Article 5(5) were to be satisfied or if the disposal test was not satisfied so as to being the case within ambit of basic rule PE under article 5(1); that was not, however, the case in the pre transfer pricing legislation era. To this extent, in my view, departure from the convention OECD approach, which is rightly questioned by Arvid A Skaaar and implied rejected by our own Authority for Advance Ruling, is fully justified. Of course, the vital question is whether there is anything to prove that there is "independence of the related companies" and whether "the opposite was proved". In the post transfer pricing legislation era, the determination of arm's length price fortifies the "independence of related companies" and nullifies the impact of the intra AE association. That situation is materially different from the situation in pre transfer pricing legislation era, particularly when there is clear *prima facie* evidence, as in this case- as discussed earlier in this order, that the transactions were not at arm's length in the sense that the reimbursement mark-up was not even equal to interest factor for the time period involved in incurring the expenditure and reimbursement of the same, and that there were certain risks assumed by a party which were not rewarded at all. The presumption of independence is thus clearly demolished on the facts of this case. The next question then is to what extent OECD Commentaries bind us. I find guidance from the observations of Hon'ble Supreme Court, in the case of **CIT Vs PVAL Kulandagan Chettiar [(2004) 267 ITR 654 (SC)],** wherein Their Lordships have, inter alia, observed that, "**Taxation policy is within the power of the Government and s. 90 of the IT Act enables the Government to formulate its policy through treaties entered into by it and even such Treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the IT Act, it would be unnecessary to refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements".** In effect thus, when OECD Commentary is the same as the judicial interpretation, one can refer to same, with approval, but when a fair and judicious interpretation takes you to some other conclusion, the OECD Commentary cannot come in the way. In other words, the settled legal position in India is that the judicial forums are not fettered by the OECD Commentaries. That apart, when Philip Moris decision was given by judicial forum of an OECD Country, i.e. Italy, and the subsequent OECD Commentary amendments sought to nullify the same, even Italy added a reservation in the commentary to the effect that " As for the subsidiary being a PE under the basic rule, it is only by the virtue of conditions imposed by the OECD Commentary position, and not by the text of the treaty provisions, that the subsidiary cannot ordinarily be a PE under the basic rule since it cannot ordinarily satisfy the disposal test vis-à-vis the foreign parent enterprise unless it business model consists of providing place to the foreign enterprise for functioning in the source country. Even without so providing the place to the foreign enterprise, the subsidiary can nevertheless be an extension or virtual projection of the foreign parent enterprise in the light of manner in which, and predominant object for which, its business activities are carried out,

and that is clearly evident from the approach adopted by the AAR in the case of **ABC *In re*** *(supra).* In the light of Hon'ble Supreme Court's guidance extracted earlier, however, the OECD Commentary, or for that purpose any Commentary, does not bind our judicial interpretation, Therefore, it is not even a question of *de legeal ferenda* vs *de lege lata* from the point of view rejecting or accepting OECD commentary on this point; the OECD approach does not anyway provide legal basis for treaty interpretation in India and it is only as persuasive as any other relevant aid to interpretation of the tax treaties. I donot, therefore, concur with the OECD theory, if it can be construed to be that OECD approach permits only subsidiary being treated as a PE only under article 5(5).

51. In Philip Baker's book on Double Taxation Conventions, there is an interesting discussion about the nature of the permanent establishments, which is beautifully captured, with approval, in paragraph 24 of Hon'ble Supreme Court's judgment in the case of Formula One World Championship Ltd *(supra)* as follows:

> Emphasising that as a creature of international tax law, the concept of PE has a particularly strong claim to a uniform international meaning, Philip Baker discerns two types of PEs contemplated under Article 5 of OECD Model. First, an establishment which is part of the same enterprise under common ownership and control – an office, branch, etc., to which he gives his own description as an 'associated permanent establishment'. The second type is an agent, though legally separate from the enterprise, nevertheless who is dependent on the enterprise to the point of forming a PE. Such PE is given the nomenclature of 'unassociated permanent establishment' by Baker. He, however, pointed out that there is a possibility of a third type of PE, i.e. a construction or installation site may be regarded as PE under certain circumstances. In the first type of PE, i.e. associated permanent establishments, primary requirement is that there must be a fixed place of business through which the business of an enterprise is wholly or partly carried on. It entails two requirements which need to be fulfilled: (a) there must be a business of an enterprise of a Contracting State (FOWC in the instant case); and (b) PE must be a fixed place of business, i.e. a place which is at the disposal of the enterprise. It is universally accepted that for ascertaining whether there is a fixed place or not, PE must have three characteristics: stability, productivity and dependence. Further, fixed place of business connotes existence of a physical location which is at the disposal of the enterprise through which the business is carried on.

52. When I read the above observations in the context of the subsidiary company being the PE, the subsidiary company can only fall in the second category of PEs i.e. of "unassociated permanent establishment" as against the first category of PEs which consists of parts of the enterprise i.e. office or branch etc, i.e. of "associated permanent establishment". In the light of the risk of expression "associated permanent establishments" being mixed up the connotations of "associated enterprises", and natural corollaries thereof, affecting this analysis at a rather subliminal level, I would rather rephrase these two types of permanent establishments, for the ease of discussions, as "direct permanent establishments" and "indirect permanent establishments". Now, in the light of the observations made by Hon'ble Supreme Court approving the path taken by Philip Baker, the fixed place of business test and disposal test is relevant only for, what I have termed as, 'direct permanent establishments' or

what Baker has termed as 'associated permanent establishments'. In other words it is only in the situations of direct PEs or associated PEs that the fixed place of business and the disposal tests are to be satisfied vis-à-vis the foreign enterprise. These twin tests are not really relevant, vis-à-vis foreign enterprise, for the second category, i.e. unassociated or indirect PEs, which has been described by Hon'ble Supreme Court, taking a clue from Baker's work, by observing that "**the second type** *(of a PE)* **is an agent, though legally separate from the** *(foreign)* **enterprise, nevertheless who is dependent on the** *(foreign)* **enterprise to the point of forming PE**". The only other category of PE visualized is a construction or installation site being regarded as PE under certain circumstances. If a subsidiary, considered to be a permanent establishment on account of, to borrow the expression employed by the AAR, not having "**significant independent activities on its own or on behalf of persons other than ..*(foreign parent company)*…and unconnected with it**" is to fit in these three types of PEs, it can only fit in the second category i.e. unassociated permanent establishment or as indirect permanent establishment, and that is the category for which the requirement of fixed place of business and disposal test vis-à-vis the foreign enterprise does not, even going by Hon'ble Supreme Court's analysis, does not apply. These tests cannot be applied in such cases for the elementary reason that when the work of a foreign enterprise is being carried out by a separate legal entity in the source jurisdiction, there is no question of the foreign enterprise using the place of business in the source jurisdiction or having such a place at its disposal since the work of the foreign enterprise is carried out by a separate legal entity and it is this separate legal entity which must have the fixed place of business at its disposal for performing actions in furtherance of the business interests of the foreign enterprise.

53. I may, however, add that so far as the second category of PEs in the preceding discussion is concerned, Hon'ble Supreme Court has only referred to "an agent, though legally separate from the foreign enterprise, nevertheless dependent on the foreign enterprise to the point of forming PE", the conventional OECD approach, which has been referred to by Baker as well, is confining it to Article 5(5)- an approach which, for the detailed reasons recorded earlier in this order and following the approach of the AAR, I have rejected. The OECD approach, which has not found favour even with well known western treaty experts like Arvid A Skaar, a Professor in the University of Oslo, does not, in my considered opinion, merit acceptance.

54. There is no point in adding much to the discussions, in the lead order, on the basic rule PE that the Indo Finnish tax treaty, like possibly all other tax treaties, provides by stating that "the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on". On the facts of this case, in my considered view, there is no dispute that the business of the foreign enterprise was, at least partly, carried out by the IC by the manner, as I have discussed in detail, IC was carrying on its business- as much, if at all, in the interest of the IC as much, even if not more at the minimum, in the interest of the foreign enterprise. The issue really is with respect to disposal test, i.e. the premises being at the disposal, qua the foreign enterprise, but then, for the detailed reasons I have set out earlier, taking things forward from certain observations in Baker's work- which is quoted with approval by Hon'ble Supreme Court's judgment in the case of **Formula One** *(supra),* in the case of 'indirect PEs' or 'unassociated PEs' as a subsidiary PE inherently is, such a disposal test can only be satisfied *qua* the agent who acts as proxy of the assessee in conducting the business. When business activities are through an agent, representative or proxy, the disposal test cannot be taken up qua the principal. There is

no conceptual justification for the confining the role of the subsidiary as a PE under article 5(5) and denying the status of PE under the basic rule, i.e. under article 5(1), when business of the parent foreign enterprise is being carried partly through a fixed place, though at the disposal of such subsidiary- in a capacity as agent, representative or proxy. The theory of 'disposal test' vis-à-vis the foreign enterprise remains confined to only the 'associated PEs', or 'direct PEs' as I put it, and cannot extend to the subsidiary PEs or, for that purpose, any other 'unassociated PE' or 'indirect PE'. To this extent, I am of the view that the approach adopted in the OECD Model Commentary, which is accepted in the UN Model Commentary as well, is not a legally acceptable position. My parallel discussions on this point, at other places in the same order and which are somewhat repetitive in that way, also lead me to the same conclusion

55. Learned counsel suggests that even if a subsidiary company is a virtual projection of the foreign enterprise, and it does business wholly or mainly for its foreign parent company, even then it cannot be treated as a PE of the foreign enterprise under the basic rule. That statement does hold good, as the position now in settled in law is by the binding judicial precedents from Hon'ble jurisdictional High Court, in a situation in which the transactions between the subsidiary and the foreign enterprise are at arm's length prices, but right now we are dealing with the cases in pre transfer pricing legislation era and in cases where the transactions between the subsidiary and the foreign enterprise are, as evident from the material on record, not on arm's length basis. That apart, the impact of Hon'ble Supreme Court on the question of applicability of disposal case in the case of indirect PEs, or, as Baker puts it, 'unassociated PEs' is to be examined nevertheless which may, to a considerable extent, end up diluting the broad case against the subsidiaries not becoming PEs of the parent foreign enterprise. His argument is that the question of 'virtual projection' is irrelevant unless all the tests of fixed place PE, including disposal test, are satisfied. What is canvassed before us is that all the elements of a normal fixed place PE are to be satisfied and, it is only when these tests are satisfied, one has to see whether there is a virtual projection or not. In support of this proposition, a lot of emphasis is laid on the observations made by Hon'ble Supreme Court to the effect that "**We are of the opinion that the test laid down by the Andhra Pradesh High Court in Visakhapatnam Port Trust case fully stands satisfied. Not only the Buddha International Circuit is a fixed place where the commercial/economic activity of conducting F-1 Championship was carried out, one could clearly discern that it was a virtual projection of the foreign enterprise, namely, Formula-1 (i.e. FOWC) on the soil of this country**". It is thus contended that, in the esteemed opinion of Hon'ble Supreme Court, in order to be a PE, there has to be a fixed place of business, which satisfied all the tests of the fixed place PE, and it must amount to the virtual projection of the foreign enterprise as well. His suggestions is, which have been accepted by the majority, that "**the concept of virtual projection does not mean that even without a fixed place, virtual projection will lead to an inference of PE**" and that "**the concept of virtual projection cannot be in vacuum *dohors* any other parameter of the PE".** It is on the basis of this reasoning that he contends that since the conditions precedent for existence of a fixed place PE, i.e. right to disposal, stability and productivity, are not satisfied, there cannot be a PE even if there is a virtual projection of the foreign enterprise by the NIPL.

56. This line of reasoning proceeds on the fallacious assumption that the concept of "virtual projection" has the same ramifications whether it is in respect of, to use the expression employed by Baker, "associated permanent establishment" (direct PE) and in

respect of "unassociated permanent establishment" (indirect PE). No doubt, when the virtual projection theory is applied in terms of "associated PEs" *(or, as I would prefer to put it- "direct PEs")*, the disposal test must be met, but this position cannot hold good for any form of "unassociated PEs" *(or, as I would prefer to put it- "indirect PEs")* by way of, in the words of Hon'ble Supreme Court, "is an agent, though legally separate from the (foreign) enterprise, nevertheless who is dependent on the (foreign) enterprise to the point of forming PE". The reason is simple. In the case of unassociated PEs, the legally separate enterprise steps into, because of its conduct, the shoes of the foreign enterprise and, in a way, acts as a proxy. In such a situation, the disposal test, vis-à-vis the foreign enterprise, is irrelevant as the separate legal entity, representing the foreign enterprise, performs most of, if not all, the actions in the proxy capacity, and, therefore, the disposal test, if all, must be vis-à-vis such a separate legal entity acting as a proxy. That is the reason that when a business is carried out through the agent (including a subsidiary or any other separate legal entity) in such a manner as it amounts to a virtual projection of the foreign enterprise, and provides a fixed place of business though which business of the foreign enterprise is carried out, the disposal test vis-à-vis the foreign enterprise has no application in determination of a PE. As I have pointed out above, the business is carried out through the agent and not necessarily by the non-resident directly and in entirety. It is important to appreciate that indirect PEs are hypothetical PEs and these are the situations in which, on account of a deeming fiction, the legal independence of the entities is relegated into insignificance by other factors and a legally independent enterprise is treated as hypothetical PE of a foreign enterprise. These situations need not necessarily, and cannot always, satisfy the disposal tests vis-à-vis foreign enterprises.

57. I may also point out that Hon'ble Supreme Court has, in the case of Formula One (supra), has not stated, as is being projected, that even in the case of virtual projections by subsidiaries, which was not even the case before Their Lordships, virtual projection must also satisfy the disposal test. Quite to the contrary, what Their Lordships have noted is that the case before Their Lordships was a case in which "**Not only** the Buddh International Circuit **is a fixed place where the commercial/economic activity** of conducting F-1 Championship **was carried out**, **one could clearly discern that it was a virtual projection of the foreign enterprise**, namely, Formula-1 (i.e. FOWC) on the soil of this country *(all emphasis supplied by me now)*". While reading this sentence, the importance of expression "not only", and the preceding discussions on the basis rule PE, cannot be ignored, and, if that is taken into account, logical conclusion is that it was a case in which the conditions precedent for basic rule PE were satisfied, and, in addition, it met the virtual projection test as well. Its almost like saying "whichever way one looks at it, it constitutes a PE nevertheless". This statement cannot read in the condition of 'virtual projection' as a *sine qua non* for the existence of basic rule PE. It is not, and it cannot be, the case of the assessee that even though all the preconditions of basic rule PE are satisfied, whatever constitutes PE cannot be treated as a basic rule PE because it does not amount to "virtual projection" of the foreign enterprise. To me, this is clearly an incongruous result. In any case, judgments of Hon'ble Supreme Court cannot be read like a statute and cannot be interpreted as answering the questions which did not even fall for the consideration of Their Lordships. If authority is needed even for this elementary proposition, one can usefully refer Hon'ble Supreme Court's judgment in the case of **CIT Vs Sun Engineering Works Pvt Ltd [(1992) 198 ITR 297 (SC)]**.

58. As regards the decision of Hon'ble Delhi High Court, in the case of **DIT Vs E Funds IT Solutions [(2014) 364 ITR 256 (Del)]**, which is now approved by Hon'ble Supreme

Court in the judgment reported as **[(2017) 399 ITR 234 (SC)]**, that was a case in which Hon'ble jurisdictional High Court had specifically observed that "…… **The international transactions between the assessees and e-Fund India and the income of e-Fund India, it is accepted, were made subject-matter of "arm's length pricing" adjudication** by the Transfer Pricing Officer (TPO, for short) and the Assessing Officer (AO, for short) in the returns of income filed by e-Fund India. We are not primarily concerned with the merits of the computation of income declared and assessed in the hands of e-Fund India in the present appeals, though **the factum that e-Fund India was assessed to tax on its global income as per law or on 'arms length pricing' in relation to associated transactions and the basis of the said computation of income earned by e-Fund India, as noticed below, is a relevant and an important fact. Revenue has not disputed the said legal position**" *(Emphasis supplied by me).* The fact of transactions between the parent company and subsidiary company being at arm's length price was thus not in dispute and, the assessments of income having been made after arm's length price adjustments, as may have been necessary, the impact of intra AE association stood nullified. Clearly, therefore, the presumption of independence not only was left intact by the Assessing Officer but was further fortified by the transfer pricing assessments of the parties. In such a situation, there cannot indeed be any occasion for assuming dependence in the parent-subsidiary relationship which is the very foundation of a subsidiary being treated as a PE of the parent company. The backdrop and the context in which the observations were made by Their Lordships cannot therefore, by default, hold good in pre transfer pricing legislation era- particularly when there are clear indicators to the position that the transactions between the parent subsidiary were not at arm's length, that the mark-up on reimbursements was far less than interest compensation for the period of incurring the expenditure and receiving reimbursements for the same and that certain functions and risks assumed by the foreign enterprise were completely unrewarded. In the backdrop of these facts, and when I bear in mind the oft quoted words of Hon'ble Supreme Court, in the case of Sun Engineering Works (supra), that "It is neither desirable nor permissible to pick out a word or a sentence from the judgment of this Court, divorced from the context of the question under consideration and treat it to be the complete "law" declared by this Court". When Their Lordships themselves observe that application of arm's length prices by the transfer pricing authorities was "a relevant and an important fact", it would not really be possible that the observations made in that case will, by default, apply on a fact situation in which not only the transfer pricing provisions were not applicable and thus arm's length price were not the basis of assessment income but there were clear indicators about the transactions being not an arm's length basis. In my humble understanding, the question whether the same principles will apply to pre transfer pricing legislation, particularly when these parent-subsidiary transactions are clearly not on arm's length basis, is not concluded by the said judgment. The other important aspect of the matter is that, after expressing the agreement with the findings of the Hon'ble High Court by stating that "**We agree with the findings of the High Court in this regard** *(that there is no fixed place PE on the facts of the present case)*, Hon'ble Supreme Court has also observed that in the said case the Indian subsidiary was not an interface of the foreign company with the Indian customers, and in that sense it was not a place of the business of the assessee in India. That is the only specific reasoning given by Hon'ble Supreme Court. Hon'ble Supreme Court has noted that " **……. no part of the main business and revenue earning activity of the two American companies is carried on through a fixed business place in India……**". Hon'ble Supreme Court upheld the stand of the assessee by expressing observing that "**…….**

It is clear from the above that the Indian company only renders support services which enable the assessees in turn to render services to their clients abroad. This outsourcing of work to India would not give rise to a fixed place PE and the High Court judgment is, therefore, correct on this score". These observations cannot be taken as approval, as well of all other propositions laid down by Hon'ble jurisdictional High Court, by Hon'ble Supreme Court. There was no occasion for Hon'ble Supreme Court to examine those aspects of the matter. In sharp contrast with this fact situation, right now the case before us is that Indian company was the face of the non-resident parent company in India, where the end customers are situated, and such an association would indeed give rise to the place of business in India. By no stretch of logic, these observations can be seen as subscribing to the theory that, as per law settled by Hon'ble Supreme Court, a subsidiary company can never be the PE of the parent non-resident company- as is being canvassed before us. On the other hand, the observations made in Formula One *(supra)* seem to support the plea that the disposal test is relevant only for 'associated PEs' which are integral part of the non-resident enterprise and are not separate legal entities.

59. There is one more factor to be borne in mind. The underlying presumption of the path taken by another special bench of equal strength in the first round of proceedings, was that the basic rule PE tests, as canvassed by the commentary, are not necessarily the tests to decide whether there is a "virtual projection" or not, in a situation in which the transactions between the related are not at arm's length, and when virtual projection can be held *de hors* these tests, it will be a PE nevertheless. This approach is clear from the fact that the coordinate special bench held the IC to be PE of the assessee company only on the basis of twin factors of transactions not being at arm's length and virtual projection of the foreign enterprise. Even though this approach was specifically in challenge before Hon'ble Delhi High Court, in question no. 2 i.e. "**Whether the Tribunal was right in law in holding that a perception of virtual projection of the foreign enterprise in India results in a permanent establishment?",** Their Lordships have, without expressing any opinion on the same, remitted the matter for reconsideration on factual aspects. As a matter of fact, the question framed by the assessee for the consideration of Hon'ble High Court hardly leaves any doubt about the legal proposition laid down of the earlier special bench, and that legal proposition still holds good. The decision of the earlier special bench on this approach, therefore, continues to be a binding judicial precedent for this special bench as well. The position will of course be difference when a bench of greater strength, or a higher judicial forum, specifically disapproves the path so taken by the earlier special bench. There was no request at all for a reference being made to the larger bench. There is no occasion thus to deviate from the earlier special bench decision on this issue.

60. Let's now deal with the mistakes pointed out by Hon'ble high Court, and impact thereof on our conclusions. In the course of the hearing, a specific question was asked as to what were the facts in Ericsson's case which were, as pleaded by the assessee before Hon'ble High Court, wrongly taken as of the case of this assessee. Learned counsel, however, could not throw any light on this aspect of the matter. Anyway, all that could be done, and that is what has been done, is that only the facts of the present case are being taken into account. I have also ignored the findings, being devoid of any material to support these findings, of the CIT (A) that (a) the Indian subsidiary has incurred huge loss and the parent company was aware of the profitability; (b) the Indian subsidiary being a one hundred percent subsidiary or parent company which having wide experience, the natural inference was that the

transactions were not at arm's length. As regards the long list of factual errors in the order of the Assessing Officer, which were specifically challenged before the CIT(A) but no dealt with by the CIT(A), I keep aside all these findings of the Assessing Officer as well.

61. Let us now quickly recapitulate facts of the case. Here is an assessee company which has a subsidiary Indian company, by the name of Nokia India Pvt Ltd (IC), and this IC provides marketing and administration support services on cost plus 5% mark-up basis and the mark-up of 5% is less than adequate inasmuch as it does not even factor for the interest element for the period for which its funds are blocked in incurring the expenses. The IC provides, under approval of the assessee company, installation services for which assessee company undertakes performance guarantee and commitment not to dilute the shareholding below 51%, so as to ensure the control over operations and resultant agreed performance level to the IC's customers, but the assessee company is not at all rewarded for these functions and risks at all. Such an arrangement cannot, therefore, be justified on the commercial considerations at all. It may also be mentioned that the services for which, the IC is so inadequately rewarded that if the IC was to park its funds employed in this activity in a fixed deposit with any Indian bank, it would have earned much more than what it has earned under this agreement, the IC has rendered a number of services, in marketing support function. These services are listed at page 2 and 3 of the agreement dated 19.4.1996, a copy of which is placed before the bench in the paperbook filed by the learned Departmental Representative.

62. In effect thus the entire marketing and administrative support work is done by the assessee in India, through the Indian subsidiary and without adequate arm's length consideration, at a fixed place in India. This is carrying on the business of the assessee in India through a fixed place of business. The visiting employees of the assessee company also use the premises of the assessee and carry out important core business functions from the place of the IC. It is important to bear in mind the fact that at no stage, including in the course of the proceedings before us, the assessee has not submitted the details about names and duration of stay of the expatriate employees who availed such support from the IC. The IC renders these important and vital services to the assessee company on a non arm's length consideration. That aspect of the matter has already been discussed in detail earlier in this order. As for the disposal test vis-à-vis the foreign enterprise, as the assessee company has done the said work inserting a separate legal entity which is working wholly and predominantly for the assessee, on consideration other than arm's length consideration, it is a case of 'unassociated PE' or 'indirect PE' which, in the light of detailed discussions earlier in this order, are not required to meet the disposal test vis-à-vis the foreign enterprise. As the Indian subsidiary, a separate legal entity, virtually works as a proxy or virtual projection of the foreign enterprise, the disposal test has to be vis-à-vis the Indian subsidiary, and there is no dispute, nor can there be any dispute on the facts of this case, that the disposal test vis-à-vis the Indian subsidiary is satisfied.

63. It is also beyond any doubt any controversy that the assessee company was also responsible, without any remuneration or reward, for ensuring certain level of quality of work in respect of the installation work undertaken by the IC. Earlier in this order, this aspect of the matter has been dealt with in considerable length. It is also not in dispute that the assessee has given specific undertaking to the end customers of the IC that, during the currency of the

agreements of the end customers with the IC, the assessee company will not dilute its equity ownership below 51%. There is no separate reward or remuneration for this function and risk as well which is again unjustifiable on commercial considerations. This non arm's length situation also indicates that, as was held in the first round of proceedings, that the distinction between the assessee company and the IC is so blurred that the IC was virtually a projection of the foreign enterprise and the IC is a PE for this reason as well.

64. An equally undisputed position is that all the installation work generated for the IC is on account of specific approval of the assessee company. The work done by the IC is thus entirely in the control of the assessee company and the work being obtained by the IC is entirely at the mercy of the assessee company. The people at the operational level in the IC also include a number of expatriates on deputation, secondment or assignment from the assessee company. The role of the assessee company was omnipotent in all the operations of the IC, and it was not only because of the ownership of the IC but also because of the business module adopted by the assessee company. There is also no dispute that the installation and other post sale services rendered by the IC were complementary to the core business operations of the assessee company. The IC, in substance and in effect, was acting as a proxy of the assessee company's interest in performance of commercial activities as well. Viewed thus, the office of the IC is a PE of the foreign enterprise which constitutes the fixed place of business through which the business of the assessee company is wholly or partly carried out. In this case also, since IC is acting in a proxy capacity, and as an agent, the disposal test has to be vis-à-vis the IC, as a proxy or as an agent, and not the foreign enterprise directly.

65. Quite interestingly, at page 6 in a written submissions filed before us, signed by one Tarandeep Singh, it is stated that "**one important aspect which is not considered by the lower authorities was that no adverse inference was drawn in the assessment proceedings of the Indian subsidiary with regard to compensation received on account of installation activities**" and that "**the learned Assessing Officer of the Indian subsidiary had duly accepted the compensation to be at arm's length which is evident from the fact that Section 92 was not invoked**". The fact that the assessee accepts application of arm's length provisions in this case implies that even though the transaction is with unrelated parties, the prices thereof are influenced by the parent company. What this plea, however, overlooks is that the assessment years before us are 1997-98 and 1998-99, whereas Section 92 was brought to the statute vide Finance Act 2001.

66. It is thus clear that even after taking into account the factual mistakes as pointed in the order of Hon'ble High Court, there is no change in the situation. The reasons are different but the conclusions, on the issue of the permanent establishment, remain the same as were arrived at by the coordinate special bench in the first round of the proceedings. In other words, these mistakes did not affect the ultimate outcome of the appeal on this point. In the light of the detailed discussions above, I am of the considered view that not only that Indian subsidiary of the assessee company provided business connection to the assessee company, the Indian subsidiary of the assessee company also constitutes permanent establishment of the assessee company under article 5(1) of the Indo Finnish tax treaty.

67. That takes me to the question as whether any profits are to be attributed to the signing, networking, planning and negotiations of the offshore supply contracts in India. These are

core marketing functions and core support technical functions which are vital to the business of sale of equipment. At the minimum, these services can be treated at par with marketing services rendered by the assessee, through its PE, in India. As has been discussed earlier, all the crucial marketing and support functions have been rendered by the Indian PE, by way of the IC, and the IC has not been adequately compensated for the same. There are judicial precedents to hold that 35% of the overall profits on sale can be attributed to the marketing function. In the case of **Rolls Royce plc Vs DCIT [(2011) 339 ITR 147 (Del)],** while upholding the stand of this Tribunal in allocating 35% of global profit to the marketing function, Their Lordships have observed as follows:

> **We are in agreement with the aforesaid view of the Tribunal. While restricting the attribution to 35 per cent, the reason given by the Tribunal was that profit attributed to manufacturing activity and research and development activities, i.e., 50 per cent and 15 per cent respectively had to be excluded. Thus the expenses on research and development were already taken care of when remuneration @ 35 per cent was attributed to marketing activities in India on which global profits was apportioned and there was no question of setting off the research and development expenses again in respect of marketing activities. We, thus, answer question No. 3 against the assessee.**

68. Learned counsel's submission is that the assessee company has, on the basis of a separate profit and loss account prepared for the equipment sales in India, incurred losses of US Dollars 2,37,52,669 for the year ended 31.3.1997 and US Dollars 86,14,672 for the year ended 31.3.1998. In view of these losses, according to the learned counsel, there cannot be any question of any profits being allocated to the sale of equipment in India.

69. I have noted that the India specific financials donot make it clear as to on what basis the allocations of expenses have been done. All that these financials show are the broad heads like Direct Costs, R& D Costs, A&G Costs, Sales and Marketing Costs and BoA advisory and financial expenses. As these financials are apparently based on sweeping generalizations and the related evidences have not been produced before any of the authorities below, I would approve the following approach of the CIT(A) in the impugned order:

> **………..On the face of it, there appears to be something wrong with the P&L a/c as direct costs were shown at U.S. Dollar 2,10,24,054. This is in the context worldwide gross profit of 28.7%. This P&L a/c was not substantiated with any documents. Therefore, it is held that these accounts are not reliable for the purpose of computing income from sale of hardware. Accordingly, assistance of Rule 10 of the I.T. Rules is taken to compute profit on the basis of global accounts. The global accounts showed net profit of 10.8% as mentioned by the Ld. AO in the assessment order. Therefore, the net profit is taken at 10.8%. The whole of this profit cannot be attributed to Indian operations as activities regarding manufacture and development of products etc. was undertaken outside India………**

70. The CIT(A) has, out of the 10.8% global profits, allocated 5% of global profits to the Indian operations. While I uphold the approach of the CIT(A) in principle, I also hold that, on the lines of Rolls Royce decision (supra), only 35% of the total profits can be allocated to the services provided by the PE, as marketing function. Accordingly, in my view, 3.78% of sales, i.e. 35% of 10.8% global profit on sales, can be reasonably allocated to the PE. I round it off to 3.75% for the purpose of computing profits attributable to the specified functions of the PE.

<u>My conclusions:</u>

71. In view of the above discussions, I hold that the assessee company had a PE in India, by way of the premises and existence of its Indian subsidiary Nokia India Pvt Ltd, and that the profit attributable to the specified operations of this PE are 3.75% of total sales of the equipment in India. In the result, while I uphold the action of the CIT(A) in principle, I marginally reduce the quantum of profits attributable to the PE. As against profit @ 5% of sales held to be attributable to the Indian PE, I hold the profit on 3.75% of sales to be attributable to PE in respect of the specified activities.

72. In the result, in my considered view, the plea of the assessee against the existence of business connection and the existence of permanent establishment is to be rejected, and plea of the assessee on the attribution of profit is to be partly accepted in the terms indicated above.

73. To this extent, even as I humbly bow to the majority so far results of these appeals are concerned, I disassociate myself with the order as finalized by the majority. Save on the above points, I am in considered agreement with the conclusions arrived at in the lead order and I respectfully endorse the same.

Pronounced in the open court today on the 5th day of June, 2018.

Sd/xx
Pramod Kumar
(Accountant Member)

New Delhi, the 5th day of June, 2018

Order pronounced in the open court today on the 5th day of June 2018.

Sd /xx	***Sd/ xx***	***Sd/ xx***
Sudhashu Srivastava*	N K Saini	Pramod Kumar
Judicial Member	Accountant Member	Accountant Member
*(*Substituted, for pronouncement of order, for Hon'ble Shri Amit Shukla- vide Hon'ble President's order dated 5th June 2018)*		