

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCHES 'E', NEW DELHI**

**Before Sh. Bhavnesh Saini, Judicial Member**

**Dr. B. R. R. Kumar, Accountant Member**

**ITA No. 1006/Del/2010 : Asstt. Year : 2004-05**

**ITA No. 1007/Del/2010 : Asstt. Year : 2005-06**

**ITA No. 1008/Del/2010 : Asstt. Year : 2006-07**

**ITA No. 5819/Del/2010 : Asstt. Year : 2007-08**

Nokia Corporation (Formerly Nokia Networks OY) C/o Tarandeep Singh, F-99, Lajpat Nagar-II, New Delhi-110024	Vs	Asstt. Director of Income Tax, Circle-2(1), International Taxation, New Delhi
<b>(APPELLANT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AABCN3748E</b>		

**ITA No. 1236/Del/2010 : Asstt. Year : 2004-05**

**ITA No. 1237/Del/2010 : Asstt. Year : 2005-06**

**ITA No. 1238/Del/2010 : Asstt. Year : 2006-07**

Asstt. Director of Income Tax, Circle-2(1), International Taxation, New Delhi	Vs	Nokia Corporation C/o S.R. Batliboi & Co., 4 <sup>th</sup> Floor, Golf View, Tower-B, Sector Road, Sector-42, Gurgaon
<b>(APPELLANT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AABCN3748E</b>		

**Assessee by : Ms. Rashmi Chopra, Adv.**

**Revenue by : Sh. G. K. Dhall, CIT DR**

**Date of Hearing: 09.07.2019**

**Date of Pronouncement: 02.09.2019**

## **ORDER**

### **Per Dr. B. R. R. Kumar, Accountant Member:**

Since, the issues involved in all these appeals are common, they were heard together and are being disposed off by common order. Ground Nos. 2 & 6 are not pressed.

2. The assessee has raised the following grounds:

*"1. Based on facts and circumstances of the case and in law, the learned Commissioner of Income-tax(Appeals) [hereinafter referred to as the CIT(A)] has erred in holding that the income earned by the appellant from supply of telecommunication equipment (comprising of hardware and software) to Indian telecom operators is taxable in India on the basis that the appellant has a Permanent Establishment ('PE') in India under the provisions of Article 5 of the Double Taxation Avoidance Agreement between India and Finland ("India-Finland tax treaty").*

*2. Not pressed*

*3. Without prejudice, based on facts and circumstances of the case and in law, the Id. CIT (A) has erred in applying global net operating margin of 16.46 percent to estimate the income from supply of telecommunication equipment.*

*4. Without prejudice, based on facts and circumstances of the case and in law, the Id. CIT (A) has erred in not considering the India specific Profit and Loss account furnished by the appellant, which reflected losses incurred from supplies made to customers in India.*

*5. Without prejudice, based on facts and circumstances of the case and in law, the Id. CIT (A) has erred in attributing 20 percent of the estimated*

*income from supply of telecommunication equipment to the alleged PE in India, by completely ignoring the following facts submitted by the appellant:*

- (a) Supply contracts/purchase orders, being high value contracts, were 'concluded/accepted' outside India in view of the fact that the 'power to conclude' contracts vests with the Board of Directors/other approving authority off the assessee based outside India at the registered office of the company in Helsinki (Finland).*
- (b) No supply contracts were signed in India.*
- (c) No income can be said to have accrued on account of mere signing of contracts, as upheld by the Hon'ble Supreme Court in the case of Ishikawajima Harima Heavy Industries Co. Ltd. (288 ITR 408)*
- (d) The appellant's role was limited to supply of telecom equipment and it did not have any role in network planning activities undertaken in India.*

*6. Not pressed*

*7. Based on facts and circumstances of the case and in law, the Id. CIT (A) has erred in upholding the action of the learned assessing officer who has arbitrarily imputed Rs 50,000,000 as income from vendor financing and taxed the same in the hands of the appellant in India as business Income, without providing any Justification for Imputation of the said Income and without seeking any information and detail from the appellant nor providing any opportunity to the appellant to contest such addition.*

*8. Based on facts and circumstances of the case and in law, the learned CIT (A) has erred in relying upon the unfounded allegations made by the learned assessing officer to hold a 'Fixed Place PE' of the appellant in India under the provisions of Article 5(1) of the India-Finland Tax Treaty, in respect of*

*research & development ('R&D') activities undertaken by Nokia India Private Limited (Nokia India) in India for the appellant.*

*8.1 Without prejudice, based on facts and circumstances of the case and in law, the learned CT (A) has erred in applying the profit margin rate of 21.42 percent on the total expenses incurred by Nokia India on R&D activities and attributing 100% of the same to the alleged PE of the appellant in India.*

*8.2 Without prejudice, based on facts and circumstances of the case and in law, the learned CIT (A) has erred in not appreciating that an arm's length payment has been made by the appellant to Nokia India in respect of R&D activities undertaken by Nokia India, which has already been offered to tax in India by Nokia India.*

*8.3 Without prejudice, based on facts and circumstances of the case and in law, the learned CIT (A) has erred in not allowing deduction for payments made by the appellant to Nokia India while computing the income from R&D activities undertaken in India.*

*9. Based on facts and circumstances of the case and In law, the learned CIT (A) has erred In upholding the levy of interest under section 234B of the Income-tax Act, 1961, thereby ignoring the Judgment of the Hon'ble Tribunal In appellant's own case for AY 1997-98 and AY 1998-99."*

3. The Revenue has raised the following grounds:

*"1. On the facts and circumstances of the case, Ld. CIT(A) has erred in attributing only 20% of profits to activity of the PE in India for supply of Hardware.*

*2. On the facts and circumstances of the case, Ld. CIT(A) has erred in attributing only 20% of profits of activity of the PE in India for supply of Operating Systems Software.*

*3. On the facts and circumstances of the case, Ld. CIT(A) has erred in attributing the profits on Research & Development (R&D) activities in the same proportion as the proportion of Global Profits are attributable to ratio of Global R&D Expenses & Global Expenses and thus disregarding the facts that Global Expenses even contain expenses of the branches where R&D activities are not even carried out."*

4. The issues in the grounds taken by the assessee as well as the revenue involved similar issues. Hence, taken up and adjudicated together.

5. Brief background of the case are that Nokia Corporation is a company incorporated under the laws of Finland and is engaged in the business of supplying advanced telecommunications systems and equipment for use in fixed and mobile phone networks. The assessee has presence in India in the form a 100% subsidiary by the name of Nokia India Private Ltd (hereinafter referred to as Nokia India). According to the assessee its Indian liaison office had become defunct after incorporation of the Indian subsidiary, Nokia India, in May 1995 and was closed in January 2002 after obtaining requisite approvals from the Reserve Bank of India. For the relevant previous years the appellant filed its returns of income declaring 'Nil' income. In the assessment orders passed by AO, the appellant has been held to constitute a PE in India and revenues derived by the appellant from following sources were taxed in India:

Supply of hardware,

Supply of operating system software

Income from Vendor financing (Only for assessment years 2003-04 to 2006-07); and

Income from Research & Development activities (Only for assessment years 2004-05, 2005-06 and 2006-07).

Revenues from supply of hardware have been allocated at 60 percent of the total supply revenues and 100% of the global profit margins earned by the appellant were attributed to the PE. Revenues from supply of software have been allocated as 40 percent of the total supply revenues and were taxed as 'royalty' both under the provisions of section 9(1)(vi) of the Act and Article 13 of the India-Finland Tax Treaty on a gross basis. Rs.5,00,00,000/- has been imputed as income from vendor financing. In respect of R&D activities, Nokia India's R&D center in India has been held as a fixed place of business for the appellant from where R&D activity of the appellant is carried out. An attribution of 125% to 130% of profits from R&D expenses incurred in India has been made.

6. Comprehensively the issues is to be adjudicated in the case are that

- Whether the appellant constitutes a PE in India, thereby resulting in taxation of revenues from supply of telecom hardware to the Indian customers
- If the appellant constitutes a PE in India, what is the quantum of profits attributable to such PE in India
- Whether revenues from supply of software are in the nature of 'royalty' / 'fees for technical services' under the provisions of the Act and the India-Finland Tax Treaty

- Whether the assessing officer has correctly imputed the income of Rs 5,00,00,000/- as income from vendor financing (Relevant for Assessment Years 2003-04 to 2006-07)
- Whether the appellant constitutes a PE in India on account of R&D activities undertaken in India under the terms of sub-contracting agreement executed between the appellant and Nokia India (Relevant for Assessment Years 2004-05 to 2006-07)

7. The orders of the Id. CIT (A) were mainly based on the order of the Special Bench of ITAT Delhi dated 22.06.2005 in the case of assessee. Later, the matter reached the Hon'ble High Court where the Hon'ble High Court has passed an order dated 07.09.2012 25 Taxman 225 dealing with the issues. Later, the Special Bench was constituted following the directions of the Hon'ble High Court and the ITAT Special Bench, Delhi passed an order dated 05.06.2018 65 ITR (T) 23 for the assessment year 1997-98 and 1998-99.

8. Ground Nos. 1, 3 to 5 of assessee's appeal in ITA Nos. 1006 to 1008/Del/2010, Ground Nos. 2 & 3 of assessee's appeal in ITA No. 5819/Del/2010 and Ground Nos. 1 to 3 of departmental appeal in ITA Nos. 1236 to 1238/Del/2010 deals with existence of permanent establishment in India.

9. With regard to the PE, the Id. CIT (A) adjudicated based on the order of the Special Bench of ITAT Delhi dated 22.06.2005. The relevant part of the order is as under:

*"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 Assessing Officer and the CIT(Appeals), the NTPL can be considered as a PE. The issue has been dealt with in paragraph 6.3 of the order of the CIT(Appeals), 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(Appeals) is only in paragraph 6.3 of his order. A reading of this paragraph shows clearly that what the CIT(Appeals) has in mind, as in the case of the A.O., 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 order of the Income-tax 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% which means that in addition to getting the expenses reimbursed, NTPL will get 5% more. It stands to reason that in respect of the marketing activity, NTPL has no scope for incurring any loss. Nevertheless, its accounts Shows 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 Income-tax 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 operator in India were not commensurate with the costs and expenses incurred therefore and that is the reason why such a loss has been incurred. Now the other question is how does that 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% 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 Income-tax authorities was that the assessee even represented to the Indian cellular operator that it will not dilute its share holding in the Indian subsidiary below 51% without the written permission of the Indian cellular operators. This allegation of the Income-tax 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% 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. Vishakhapatnam Port Trust 144 ITR 146 is fully answered. We are, therefore, unable to find fault with the CIT(Appeals) for holding that NTPL, the 100% Indian subsidiary of the assessee, constituted the assessee's PE in India." (Emphasis Supplied).*

*As I have mentioned above, the facts of the case before me for Assessment Years 2002-03 to 2006-07 are similar to the facts before the Honourable Special Bench of the Delhi ITAT for AY 1997-98 and 1998-99. Accordingly, relying on the decision of the Honourable Special Bench of the Delhi ITAT, I confirm the action of the assessing officer in this*

*regard and uphold that the Nokia India constitutes appellant's PE in India."*

10. It was brought to our notice that this matter of dependent agent PE, fixed based PE and attribution of profits have been discussed and stands adjudicated by the order of the Special bench of ITAT Delhi dated June 05, 2018. The relevant portion of the order is reproduced hereunder for ready reference.

*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 Asstt. DIT v. E-Fund IT Solution (supra) , 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 Id. 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 Id. 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 Id. 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, Id. 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 Id. 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 Paragraphs 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 state 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 v. 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(1)(i) of the Act clearly provide that income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be taxable in India if they come within the meaning of income deemed to accrue or arise in India as explained in Section 9 of the Act. 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 v. R. D. Aggarwal and Co. [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. v. DIT [2016] 386 ITR 353/241 Taxman 464/69 taxmann.com 47 and submitted that this judgment squarely clinches the issue in favour of the assessee and strongly relied upon paragraphs 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. (supra) 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 took 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. Addl. CIT [1983] 143 ITR 452/[1984] 17 Taxman 256. 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. v. CIT [1972] 86 ITR 417 (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.*

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*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 paragraphs 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 Id. 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 (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. v. CIT [1954] 26 ITR 27, CIT v. Ashokbhai Chaamanbhai [1965] 56 ITR 42, CIT v. Shoorji Vallabhdas and Co. [1962] 46 ITR 144 and Godhara Electricity Co. Ltd. v. CIT, [1997] 225 ITR 746/91 Taxman 351. Further, the judgment of Hon'ble Supreme Court in the case of*

*State Bank of Travancore, (supra) which has been relied upon by the Id. CIT (A), has not been treated to be correct enunciation of law by the Hon'ble Supreme Court in the case of Godhara Electricity Co. Ltd. (supra) and UCO Bank (supra). Here in the present case, the assessee itself has not treated the amount of interest to be due from any of the telecom 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 Excel Industries Ltd. (supra). 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."*

11. Since, the matter of PE stands adjudicated in favour of the assessee, in the absence of any change in the material facts, following the earlier order of this Tribunal, we hereby hold that the assessee do not have a PE within the terms of Article 5 of India-Finland DTAA. Thus, this ground of appeal of the assessee is allowed.

12. Ground Nos. 4 to 6 of assessee's appeal in ITA No. 5819/Del/2010 and Ground No. 2 of departmental appeal in ITA Nos. 1236 to 1238/Del/2010 deals with supply of equipment as hardware and software arbitrarily basis and whether the consideration towards the software portion of the equipment is in the nature of royalties under Article 13 of India-Finland DTAA.

13. The order of the Id. CIT (A) on the taxability of the supply of hardware in relation to the PE has already been discussed above.

14. Regarding the taxability of revenue from supply of software, the Id. CIT (A) held that since software is an integral part of the telecom hardware and software supply has been made pursuant to the contract in respect of which a PE has been upheld, software is effectively connected to the PE and should be dealt with as the "business profits" in accordance with provisions of Article 7. In view thereof, there is no need to segregate the payments for software from other business receipts from supply of telecom

hardware. The same view has also been upheld by the Honourable Special Bench of the Delhi ITAT for Assessment Years 1997-98 and 1998-99 wherein at Para 281 of the order, it has held as under:

*"The fourth question is regarding the treatment to be accorded to the payments made to the assessee for supply of software. The AO has assessed the payments as royalties but the CIT(A) has assessed it as business profits on the ground that the assessee has a PE in India in the form of Both "LO" and NTPL. On this point, the parties are agreed that the nature of payments made by the cellular operators for use of software supplied by the assessee alongwith the hardware is the same as in the cases of Ericsson and Motorola. Only one aspect needs to be noticed in this case and that is that in para 8.1 of his order, the CIT (Appeals) has decided that the amount paid for use of the software is to be treated as the commercial income or business profits of the assessee since the assessee had been held by him to have PE in India. However, the nature of the payment had been found by us in the cases of Ericsson and Motorola to be not royalty at all. We have found that the payment is for a copyrighted article and not the copyright right. The same finding holds good in this case also. Therefore, even Article 13.6 of the DTAA which provides that if the foreign enterprise has a PE in India, the royalties shall be taxed not under Article 13 but as business profits under Article 7 of the DTAA will not be attracted. In other words even though we have held that the 100% Indian subsidiary of the assessee, namely, NTPL, constitutes the assessee's PE in India, the payment for the software cannot be assessed under Article 15 for the reasons that it is not in the nature of royalty. However, a question may arise as to why the payment cannot be assessed as "business profits under Article 7. The reason is that the software has been held by us to be part of the GSM Cellular Systems as a whole, the sale of which has taken place outside India as held by us earlier."*

*Accordingly, relying on the decision of the Honourable Special Bench of the Delhi ITAT, I hold that there is no need to bifurcate the payments from supply of telecommunication system separately into hardware and software. The entire receipts in respect of the contract for Supply of telecom equipment including hardware and software shall be treated as business Income."*

15. This issue has been summarized in the judgment of Hon'ble High Court as under:

**"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 relevance 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:—*

<b>Revenue Appeals before Hon'ble High Court (lead case ITA 512/2007)</b>	
<i>Substantial Question of Law admitted by Hon'ble High Court</i>	<i>Conclusions</i>
<i>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?</i>	<b>Decided in favour of assessee</b> (Para 23 of HC Order)
<i>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?</i>	
<i>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</i>	<b>Decided in favour of assessee</b> (Para 30 of HC Order)
<i>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</i>	<b>Issue remitted back to AO</b> (Para 31 of HC Order)
<i>Q5. Whether on facts and in law interest under section 234B is leviable?</i>	<b>Decided in favour of assessee</b> (Para 30 of HC Order)
<b>Assessee Appeals before Hon'ble High Court (ITA 1137 &amp; 1138/2007)</b>	

<p><i>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?</i></p>	<p><b>All these Issues have been remitted back to ITAT (Para 38 of High Court order)</b></p>
<p><i>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?</i></p>	
<p><i>Q3. Whether prejudice, if the answers to Q.1 &amp; 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?</i></p>	
<p><i>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?</i></p>	

16. From the above, we find that the issue of supply of hardware has been dealt in point no. 2 at para 6.1 and supply of software which is integral to the supply of hardware and taxing it royalty has been decided vide Question No. 3 by the Hon'ble High Court of Delhi vide order dated 7<sup>th</sup> September 2012. It stands adjudicated that the sale of hardware took place outside India and hence no income from sale of hardware accrued to Nokia in India. The issue of royalty on the software has been held in favour of the assessee based on the order in

the case of (343 ITR 470) DIT Vs Ericsson AB. It was held that these payments cannot be said to be in the nature of royalty either as per the Indian Income Tax Act or DTAA and hence cannot be held to be taxable. It was held that what was sold was a GSM which consisted both hardware as well as the software and hence they cannot be taxed under two different articles. For ready reference the relevant part of the judgment of the Hon'ble High Court is reproduced as under:

*"QUESTION OF LAW NOS. 3 & 5*

*25. This aspect has already been discussed in detail by us in DIT v. Ericsson A.B. [2012] 343 ITR 470 / 204 Taxman 192 / [2011] 16 taxmann.com 371 (Delhi) which reasoning equally applies to these cases. The relevant portion of the said judgment is reproduced below:*

*"55. Once we proceed on the basis of aforesaid factual findings, it is difficult to hold that payment made to the assessee was in the nature of royalty either under the Income-Tax Act or under the DTAA. We have to keep in mind what was sold by the assessee to the Indian customers was a GSM which consisted both of the hardware as well as the software, therefore, the Tribunal is right in holding that it was not permissible for the Revenue to assess the same under two different articles. The software that was loaded on the hardware did not have any independent existence. The software supply is an integral part of the GSM mobile telephone system and is used by the cellular operator for providing the cellular services to its customers. There could not be any independent use of such software. The software is embodied in the system and the revenue accepts that it could not be used independently. This software merely facilitates the functioning of the equipment and is an integral part thereof. On these facts, it would be useful to refer to the judgment of the Supreme Court in TATA Consultancy Services v. State of Andhra Pradesh, 271 ITR 401, wherein the Apex*

*Court held that software which is incorporated on a media would be goods and, therefore, liable to sales tax. Following discussion in this behalf is required to be noted:-*

*"In our view, the term "goods" as used in Article 366(12) of the Constitution of India and as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd.(supra). A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (In case of painting) or computer discs or cassettes, and marketed would become "goods". We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of paintings or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc. The software programmes have all these attributes.*

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29. *Our reasoning given in Ericsson A.B. (supra) therefore would apply to this case as well. Even otherwise, we find, as a fact, the assessee had entered into contract for supply of GSM equipment. Responsibility for installation and commissioning of the equipment and provisioning of technical services was untaken by NIPL undertaken its separate contract with Indian customers. This installation contract has not been entered into between the assessee and Tata. We also find that Clause 19.1 of the supply contract between the respondent and Tata has been examined threadbare by the ITAT Special Bench in para 277 to hold that title and risk in the equipment has passed to Tata outside India and thereafter, Tata continues to hold the hardware at their own risk and therefore, no part of the contract prior to the passing of the title and risk could be lawfully terminated by it. Tata's right to terminate the contract in case of breach of any material condition relates to failure on the part of the respondent to supply fully functional equipment. Clause 19.1 of the supply contract with Tata does not provide that non-performance of "Acceptance Test" is a material condition for breach of the supply contract and reference placed by the Revenue is factually incorrect. That contract further reveals that NIPL was responsible for undertaking acceptance test under the terms of its installation contract with the Indian customers. The fact that Acceptance Test was to be done by respondent's subsidiary, NIPL has been specifically noted by the ITAT Special Bench in para 279. We are therefore, of the opinion that this submission of the Revenue is factually in correct.*

30. *Question nos.3 and 5 are accordingly decided in favour of the assessee and against the Revenue."*

Thus, this ground of appeal of the assessee is allowed.

17. Ground No. 7 of assessee's appeal in ITA Nos. 1006 to 1008/Del/2010 and Ground No. 9 of assessee's appeal in ITA

No. 5819/Del/2010 deals with taxability of the notional interest /vendor financing on delayed consideration for supply of equipment and licensing of software.

18. On this issue, the Id. CIT (A) has upheld the addition made on the notional interest @ 18% based on the judgment of Special Bench of ITAT Delhi dated 22<sup>nd</sup> June 2005. The relevant part of the Id. CIT (A) is as under:

*"The appellant has submitted that the assessing officer has arbitrarily imputed an income of Rs 5,00,00,000/- from vendor financing for each of the Assessment Y ears 2003-04 to 2006-07, without assigning any reasons in his assessment order, Further, as per the appellant while imputing income from vendor financing at Rs 5,00,00,000/- the assessing officer has not provided any basis for the same. The said income has been considered as "business income" and taxed at the rate of 40 percent (plus surcharge and cess) on the basis that such income is taxable in India as per provisions of the India-Finland tax treaty.*

*In my view, this issue does not need any detailed discussion. The mere fact that no credit was taken in the account books for interest cannot stop the accrual thereof as the appellant's income. The Honourable Special Bench of the Delhi ITAT at Para 283 of the order has held that income from vendor financing has been rightly imputed since there is no evidence on record to substantiate that such interest was not charged. Para 283 of the order reads as under:*

*"We have considered the facts and the rival contentions but we find no Substance in the assessed's case. The findings of the CIT (Appeals) have not been refuted before us on the basis of any material or evidence. The existence of the clause in the agreement for charging interest @ 18% p.a. is not denied. All that is contended is*

*that the clause was not activated but this contention is without substance because if the agreement is in force then it is in force with all its clauses which includes the charging of interest. It was for the assessee to show on the basis of any evidence or correspondence or subsequent agreement modifying the earlier agreement under which interest was chargeable. This has not been done. The mere fact that no credit was taken in the account books for the interest cannot stop the accrual thereof as the assessee's income. Even before us no evidence was filed to show that the financial position of the cell operators was bad and that there was an agreement between the parties not to charge interest or not to activate the clause providing for interest. In these circumstances, we uphold the addition for both the years."*

*Respectfully, following the decision of the Honourable Special Bench of the Delhi TATAT, I hold that income from vendor financing is taxable in the hands of the appellant. In the absence of details from the appellant, the AO was right in estimating this income. Therefore, the addition of Rs. 5,00,00,000/- on this account is upheld for each of the AYs 2003-04 to 2006-07."*

19. Much water has flown subsequent to the order of the Special Bench of ITAT on which the Id. CIT (A) relied upon. Subsequently, post High Court order in the case of the assessee, a Special Bench of ITAT Delhi vide order dated 5<sup>th</sup> June 2018 has decided this issue in favour of the assessee. For ready reference, the order of the Special Bench of ITAT Delhi dated 5<sup>th</sup> June 2018 is reproduced as under:

*"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 Id. 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 (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. v. CIT [1954] 26 ITR 27, CIT v. Ashokbhai Chaamanbhai [1965] 56 ITR 42, CIT v. Shoorji Vallabhdas and Co. [1962] 46 ITR 144 and Godhara Electricity Co. Ltd. v. CIT, [1997] 225 ITR 746/91 Taxman 351. Further, the judgment of Hon'ble Supreme Court in the case of State Bank of Travancore, (supra) which has been relied upon by the Id. CIT (A), has not been treated to be correct enunciation of law by the Hon'ble Supreme Court in the case of Godhara Electricity Co. Ltd. (supra) and UCO Bank (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 Excel Industries Ltd. (supra). 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."*

As a result, appeal of the assessee on this ground is allowed.

20. Ground No. 8 of assessee's appeal in ITA Nos. 1006 to 1008/Del/2010, Ground Nos. 7 & 8 of assessee's appeal in ITA No. 5819/Del/2010 and Ground No. 3 of departmental appeal in ITA Nos. 1236 to 1238/Del/2010 deals with taxability of revenue from R&D activities undertaken in India.

21. The background of the issue is that Nokia India, the Indian subsidiary of the assessee has carried out R&D activities for the assessee during the AYs 2004-05 to 2006-07 in terms of the "Research and Development Subcontracting Agreement". AO in the assessment orders for these years has held that Nokia India constitutes 'fixed places PE' and 'Dependent Agent PE' of the assessee in respect of these R&D activities.

22. The Id. CIT (A) held that since the assessee does not have separate accounts in respect of such expenses and revenues relatable to them and determination of profits attributable to the PE poses difficulties. Therefore in terms of Article 7

(paragraphs 3 and 4) of the DTAA, application of Rule 10 of IT Rules, 1962 by the AO is upheld. However, as far as the attribution ratio of 126% to 130% is concerned, it was held that the same is excessive. From the calculations of the AO mentioned above it is seen that he has attributed 100% of the profits to R&D activities. Profit of an enterprise is the result of various activities like manufacturing, selling and distribution, financing, branding, goodwill, R&D and logistics etc. R&D is thus, one of the activities amongst several others which results into profits to the enterprise. A rational basis of allocation of profits to R&D would be in the proportion R&D expenses to total expenses i.e. in the year 2004 which has been considered as an example, R&D expenses of 3,733 million Euros is about 15.20% of the total expenses of 24,558 million Euros of expenses. Therefore, it would be fair to allocate 15.20% of the profits of the appellant (i.e. 716 million Euros of a total profit of 4,709 million Euros) to the R&D activities for the year 2004. The proportion of such profits to the total R&D expenses would then be 1917 i.e. 19.17% (716 million Euros divided by total R&D expenses of 3,733 million Euros). Thus for the year 2004 the figure of attributable profits would be equal to total expenses incurred on R&D activities in India during the year multiplied with the proportion/ attribution ratio of .1917 or 19.17%. Holding this, the Id. CIT (A) directed that AO should calculate weighted average of attribution ratio by the methodology below:

i) He should first work out the weighted average of attribution ratio in accordance with the method discussed above and

ii) He should then multiply the expenses incurred on R&D in India in a particular AY with the weighted attribution ratio for that year.

23. Before us, during the hearing, the Id. AR argued that the similar matter has been adjudicated by the Hon'ble High Court of Delhi in the case of Adobe Systems Incorporated 69 taxmann.com 229 vide order dated 16th May 2016. The Id. DR relied on the order of the revenue authorities.

24. The brief facts of that case are the assessee was a company incorporated under the laws of Delaware in USA. It provided software solutions for network publishing which included web, print, video, wireless and broadband applications. The assessee had a wholly owned subsidiary in India, namely, Adobe India. Adobe India provided software related Research and Development (R&D) services to the assessee and the assessee did not have any business operations in India. The R&D services rendered by Adobe India, were paid for by the assessee on cost plus basis in terms of an agreement entered into between the assessee and Adobe India. For relevant years, the Assessing Officer and the TPO accepted the fees paid by the assessee on cost plus 15 per cent basis as being on ALP and Adobe India's assessment was made accordingly. Subsequently, the Assessing Officer sought to reopen the assessment. The reasons recorded for said purpose were that activities carried out by Adobe India were a part of the assessee's core business activities and, consequently, Adobe India constituted the assessee's PE under article 5(1) of DTAA. The Assessing Officer further reasoned that since the

assessee had a PE in India, a part of the profit accruing to the assessee which was attributable to the activities in India was chargeable to tax under the Act.

25. At this juncture, we find that the facts of Adobe Systems Incorporated are similar to the assessee and the issue in question before us. The Id. CIT (A) held that there is fixed PE in terms of Article 5 of DTAA. The premises have been used for carrying R&D activities of the assessee and the assessee has paid for all the costs and facilities. The assessee had control and authority to decide the R&D projects undertaken by Nokia India. The premises have been in control of the assessee. These issues have been clearly dealt by the Hon'ble High Court in their order. Further, the Hon'ble High Court has also taken queue from the order of E-Funds IT Solutions regarding the fixed place PE. The reasoning of the Id. Assessing Officer in the case of Adobe Systems and the order of the Hon'ble High Court dealing with the fixed PE is as under:

*"Reasons to believe that income had escaped assessment.*

*12. In the reasons recorded by the AO for issuance of the impugned notices, the AO had recorded that: (a) Adobe India develops software for the Assessee for which Adobe India has been compensated on a 'cost plus profit basis'; (b) the ownership of the software developed by Adobe India is the sole property of the Assessee and Adobe India does not retain any intellectual property rights in respect of the software developed by it; (c) the Assessee makes substantial profits by selling the software developed in India abroad for which no taxes have been paid by the Assessee in India; (d) Adobe India has been working wholly and exclusively for the Assessee and*

*does not develop software for any other concern; and (e) the Assessee's transaction with Adobe India are not isolated transactions "but a continuous business connection as Adobe India is connected to the Assessee through a network of lease lines and other technological means".*

*13. On the basis of the above, the AO concluded that activities carried out by Adobe India were a part of the Assessee's core business activities and, consequently, Adobe India constituted the Assessee's PE under Article 5(1) of the Indo-US Double Taxation Avoidance Agreement (DTAA). He also observed that in terms of the agreement between Adobe India and the Assessee, the Assessee was obliged to provide assistance, specifications and supervision and was further entitled to audit the facilities of Adobe India for maintenance of the requisite standards. This, according to the AO, indicated that the Assessee had a Service PE in India in terms of Article 5(2)(l) of the Indo-US DTAA. According to the AO, Adobe India was also a dependent agent of the Assessee and thus, constituted its PE in terms of Article 5(5) of the Indo-US DTAA.*

*14. The AO reasoned that since the Assessee had a PE in India, a part of the profit accruing to the Assessee which is attributable to the activities in India was chargeable to tax under the Act.*

*15. The AO further observed that the transaction between the Assessee and Adobe India involved transfer of intangibles and multiple interrelated transactions which could not be evaluated separately for the purposes of determining ALP by any one transaction. The AO also recorded that development and customisation of software was a highly technical job and the same could not be restricted to computation on cost plus basis. In his view, cost plus basis was not a suitable method for intangibles like software services and the Profit Split Method was applicable in terms of Rule 10B of the Income Tax Rules. Finally, the AO took note of the global profits reported by the Assessee and held that the same*

*should be apportioned in the ratio of the R&D expenses incurred by the Assessee."*

26. The order of the Hon'ble High Court dealing with the issue above as under:

*"32. Para (1) of Article 5 defines a PE to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term 'fixed place of business' includes premises, facilities, offices which are used by an enterprise for carrying on its business. The fixed place must be at the disposal of an enterprise through which it carries on its business wholly or partly. Although, the word 'through' has been interpreted liberally but the very least, it indicates that the particular location should be at the disposal of an Assessee for it to carry on its business through it. These attributes of a PE under Article 5(1) of the Indo-US DTAA were elucidated by the Supreme Court in Morgan Stanley & Co. Ltd. (supra). In a recent decision, a Division Bench of this Court in DIT v. E-Funds IT Solution [2014] 364 ITR 256/226 Taxman 44/42 taxmann.com 50 (Delhi) reiterated the above-stated attributes; after quoting from various authors, this Court held that "The term 'through' postulates that the taxpayer should have the power or liberty to control the place and, hence, the right to determine the conditions according to its needs". In the present case, there is no allegation that the Assessee has any Branch Office or any other office or establishment through which it is carrying on any business other than simply stating that Adobe India's constitutes the Assessee's PE. There is no evidence that the Assessee has any right to use the premises or any fixed place at its disposal. The AO has simply proceeded on the basis that the R&D services performed by Adobe India are an integral part of the business of the Assessee and therefore, the offices of Adobe India represent the Assessee's fixed place of business. Thus, clearly the right to use test or the disposal test is not satisfied for holding that the Assessee has a PE in India in terms of Article 5(1) of the Indo-US DTAA.*

33. *In E-Funds IT Solution (supra), this Court had expressly negated that an assignment or a sub-contract of any work to a subsidiary in India could be a factor for determining the applicability of Article 5(1) of the Indo-US DTAA. The Court had further expressly held that :*

*"Even if the foreign entities have saved and reduced their expenditure by transferring business or back office operations to the Indian subsidiary, it would not by itself create a fixed place or location permanent establishment. The manner and mode of the payment of royalty or associated transactions is not a test which can be applied to determine, whether fixed place permanent establishment exists.*

*Reference to core of auxiliary or preliminary activity is relevant when we apply paragraph 3 of Article 5 or when sub-clause (a) to paragraph 4 to Article 5 is under consideration. The fact that the subsidiary company was carrying on core activities as performed by the foreign assessee does not create a fixed place permanent establishment."*

34. *Thus, the AO's view that Adobe India constituted the Assessee's PE in terms of paragraph 1 of Article 5 of the Indo-US DTAA is palpably erroneous and not sustainable on the basis of the facts as recorded by him.*

35. *We also find that there is no material to hold that the Assessee's employees constitute a Service PE in terms of Article 5(2)(1) of the Indo-US DTAA. The Assessee has denied that any of its employees has rendered any service in India. There is no material available with the AO that would contradict the same. The AO has concluded that the Assessee has a PE in India in terms of Article 5(2)(1) of the Indo-US DTAA, only on the basis that the Assessee has a right to audit Adobe India and that the agreement between the Assessee and Adobe India entails that the Assessee would provide specifications, assistance and supervision for the R&D services procured by the*

*Assessee. The said terms of the agreement do not in any manner indicate that the Assessee has been providing services in India. Clause 5.5 of the agreement referred to by the AO indicates that the Assessee is authorized to audit the Indian subsidiary (Adobe India), so as to ensure that Adobe India adheres to the standards required by the Assessee. The same cannot possibly lead to the inference that the Assessee has been rendering services to Adobe India. The stipulation as to provide specification and further assistance is only for the purpose of ensuring that the Assessee procures the service that it has contracted for from Adobe India. Such clauses in the agreement cannot lead to an inference that the Assessee has a PE in India for rendering services, that is, a Service PE in terms of Article 5(2)(1) of the Indo-US DTAA. This has also been authoritatively held by Supreme Court in Morgan Stanley & Co. Ltd. (supra)."*

27. Since, the matter is squarely applicable to the instance case, we hereby hold that fixed place PE do not exist as the right to use test or the disposal test is not satisfied. The appeal of the assessee on this ground is allowed.

28. Ground No. 9 of assessee's appeal in ITA Nos. 1006 to 1008/Del/2010, Ground No. 12 of assessee's appeal in ITA No. 5819/Del/2010 deals with levy of interest u/s 234B of the Act.

29. In view of the decision on the grounds no. 1 to 8.3 in favour of the assessee, the adjudication on this issue becomes academic in nature and hence we refrain to do so.

30. In the result, appeals of the assessee on the grounds-

- a. Existence of PE – allowed
- b. Taxability of the software – allowed
- c. Taxability of the notional interest – allowed
- d. R&D activities – allowed

e. Interest u/s 234B – infructuous.

The appeals of the revenue are dismissed.

(Order pronounced in the open Court on 02.09.2019)

Sd/-

**(Bhavnes Saini)**  
**Judicial Member**

**Dated: 02/09/2019**

\*Subodh\*

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

**(Dr. B. R. R. Kumar)**  
**Accountant Member**

**ASSISTANT REGISTRAR**