IN THE INCOME TAX APPELLATE TRIBUNAL

"I" BENCH, MUMBAI

BEFORE SHRI PRASHANT MAHARASHI, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA No.1805/Mum./2007	**ITA No.118/Mum./2006**
(Assessment Year : 2003–04)	(Assessment Year : 2001–02)

ITA No.1803/Mum./2007
(Assessment Year : 2001–02)

Nagase And Company Ltd.
C/o S.R. Batliboi & Co.
18th Floor, Express Towers
Nariman Point, Mumbai 400 021
PAN – AABCN2879G

……. Appellant

v/s

Asstt. Director of Income Tax
International Taxation
Range–3(2), Mumbai

…….Respondent

ITA No.343/Mum./2006	**ITA No.2312/Mum./2007**
(Assessment Year : 2001–02)	(Assessment Year : 2003–04)

Asstt. Director of Income Tax
International Taxation
Range–3(2), Mumbai

……. Appellant

v/s

Nagase And Company Ltd.
C/o S.R. Batliboi & Co.
18th Floor, Express Towers
Nariman Point, Mumbai 400 021
PAN – AABCN2879G

…….Respondent

Assessee by : Shri Nitesh Joshi
Revenue by : Shri C.T. Mathews

Date of Hearing – 17/06/2022	Date of Order – 09/09/2022

O R D E R

PER SANDEEP SINGH KARHAIL, J.M.

The present cross appeals have been filed by the assessee and Revenue challenging the separate impugned orders passed under section 250 of the Income Tax Act, 1961, ('*the Act*') by the learned Commissioner of Income Tax (Appeals), Mumbai, ['*learned CIT(A)'*], for the assessment years 2001-02 and 2003–04.

2. Since both the cross appeals pertain to the same assessee and issues involved are, inter-alia, common, therefore, these appeals were heard together as a matter of convenience and are being adjudicated by way of this consolidated order. We may now take up for consideration the cross appeals filed by the assessee and the Revenue for assessment year 2003-04 against the impugned order dated 21/12/2006, passed by the learned CIT(A)–33, Mumbai, which in turn has arisen from the assessment order dated 28/02/2006, passed by the Assessing Officer ('*AO'*) under section 143(3) of the Act.

ITA No. 1805/Mum./2007
Assessee's Appeal – A.Y. 2003–04

3. In this appeal, assessee has raised following grounds:

"Based on the facts and circumstances of the case, Nagase and Company Limited, Japan (hereinafter referred t as the Appellant') craves leave to prefer an appeal against the order passed by the learned of Income-tax (Appeals)-XXXIII, Mumbai (hereinafter referred to as the learned CIT(A)

under section 250 of the Income-tax Act, 1961 (hereinafter referred to as the "Act) in respect of the order passed by the Assistant Director of Income-Tax, International Taxation Range 321 Mumbai (hereinafter referred to as the 'learned AO) under section 143(3) of the Act, on the following grounds:

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

2.Without prejudice to ground I above, the learned CIT(A) erred in not accepting the principle that only the profits attributable to the Indian operations of the Appellant should be considered taxable in India.

3. Without prejudice to grounds to 2 above, the learned CIT(A) has erred in not accepting the principle that the profits attributable to the PE, if any, should be computed in accordance with Article 7(1) and 7(2) of the India-Japan tax treaty, by adopting the average rate of commission paid by the Appellant to its independent agents.

4. The learned CIT (A) has erred in upholding the levy of the interest under section 234B of the Act.″

4. The issue arising in ground No. 1, raised in assessee's appeal, is pertaining to consideration of liaison office as Permanent Establishment (*'PE'*) of the assessee in India under Article 5 of India and Japan Double Taxation Avoidance Agreement (*'DTAA'*).

5. The facts of the case pertaining to this issue, as emanating from the record, are: The assessee before us, M/s Nagase and Company Ltd., is a public company incorporated in Japan, which is engaged in the business of import/export as well as domestic sales of dye stuffs, chemicals, plastic, machinery, electronic materials, cosmetics, health foods and medical equipment. In 1974, the assessee opened a liaison office in Mumbai after obtaining necessary approvals from the Reserve Bank of India (*'RBI'*). In terms of the permission of RBI, liaison office's activities are confined to the

liaison and representative activities and it is not permitted to carry out any business/commercial activities in India. In the present case, there is no dispute regarding the scope of permission granted by RBI to the liaison office. For the year under consideration, return of income was filed by the assessee on 22/10/2003 declaring total income at Rs. Nil. The return of income was accompanied with statement of computation of taxable income, profit and loss account, balance sheet, receipt and payment account and auditor's report. A survey under section 133A of the Act was conducted at the office premises of liaison office on 06/02/2003 and certain books of account/documents were impounded. During the course of assessment proceedings, the assessee was asked to explain as to why there is no PE in India. In reply, assessee submitted that the liaison office is carrying out only support activities and is, thus, engaging in carrying out all the preparatory and auxiliary activities. Therefore, it was submitted by the assessee that it does not constitute PE in India. Vide assessment order dated 28/02/2006, passed under section 143(3) of the Act, AO did not agree with the submissions of the assessee. The AO on the basis of documents/books of accounts and other papers impounded during the course of survey under section 133A of the Act came to the conclusion that liaison office's activities are not confined to the liaison work only, but it is also actively engaged in business activity (i.e. sales in India). The AO by referring to its findings rendered in assessee's own case for assessment year 1996–97 to 2002–03, which were also upheld by the learned CIT(A), held that Mumbai office of

the assessee i.e. the liaison office constitutes PE of the assessee in India. The AO, further, treated 10% of the total turnover from India as taxable profit under Rule 10 and accordingly, made an addition of Rs. 8,23,07,287. In appeal, learned CIT(A) vide impugned order dismissed the appeal filed by the assessee on the issue of existence PE by relying upon its predecessor's order in assessee's own case for assessment year 2002–03. Further, learned CIT(A) granted partial relief to the assessee in respect of computation of taxable profit and directed the AO to consider only 4.29% as against 10% profit determined vide assessment order. The learned CIT(A) also allowed deduction of general and administrative expenses claimed by the assessee. Being aggrieved, both the assessee and the Revenue are in appeal before us.

6. During the course of hearing, learned Authorised Representative (*'learned AR'*) submitted that the documents found during the course of survey under section 133A of the Act were also the basis of assessment / reassessment in the case of the assessee for preceding and subsequent assessment years. The issue whether liaison office of the assessee constitutes PE within India under the DTAA has came up for consideration before the coordinate benches of the Tribunal in assessee's own case, wherein after consideration of the material available on record the coordinate benches came to the conclusion that liaison office doesn't constitute assessee's PE in India. The learned AR also fairly submitted that, while deciding the aforesaid issue in favour of the assessee, the coordinate

bench of the Tribunal had clarified that the issue of existence of PE needs to be examined in each and every assessment year on the basis of facts relevant to that year. The learned AR by referring to the impounded documents pertaining to the year under consideration, which are forming part of the paper book from page No. 89-109, submitted that none of these documents goes to support the case of the Revenue that liaison office was performing activities other than for which it had received permission from the RBI and thus, constitutes PE of the assessee in India under the provisions of DTAA. It was further submitted that the liaison office collects and provides information about the Indian market, economy and political developments to the Head Office and whenever decision is made to introduce a product in the Indian market, the Head Office request the liaison office to collect information about the market.

7. On the other hand, learned Departmental Representative ('*learned DR*') submitted that the liaison office of the assessee in India was also actively involved in concluding sales within India and had the authority to negotiate price on behalf of the assessee. Therefore, the liaison office was rightly considered as PE of the assessee in India by the lower authorities.

8. We have considered the rival submissions and perused the material available on record. As per Article 7 of DTAA, profit of foreign enterprise shall be taxable in India only if such enterprise carries on business in India through a permanent establishment situated therein. Article 5 of the DTAA

defines the term permanent establishment. Further, as per the provisions of Article 5(6)(e), maintenance of a fixed place of business solely for the purpose of carrying on, for the foreign enterprise, any other activity of a preparatory or auxiliary character shall not be considered as permanent establishment. While dealing with the meaning of the term '*preparatory'* and '*auxiliary'* in context of India UAE DTAA, Hon'ble Supreme Court in Union of India vs UAE Exchange Centre, [2020] 425 ITR 30 (SC), observed as under:

> *"The expression "preparatory" is not defined in the 1961 Act or the DTAA. The dictionary meaning of that expression can be traced to term "preparatory work" and "travaux preparatoires", which in the Black's Law Dictionary (Eleventh Edition), read thus: —*
>
> > *"preparatory work. See TRAVAUX PREPARATOIRES.*
> >
> > *travaux preparatoires. Materials used in preparing the ultimate form of an agreement or statute, and esp. of an international treaty; the draft or legislative history of a treaty."*
>
> *The expression "auxiliary" is also not defined in the 1961 Act or the DTAA. In common parlance, the meaning of that expression is predicated in Concise Oxford English Dictionary (Twelfth Edition), which reads thus: —*
>
> > *"Auxiliary- adj. providing additional help or support. n. an auxiliary person or thing. N. Amer. A group of volunteers who assist a church, hospital, etc. with charitable activities."*
>
> *In Black's Law Dictionary (Eleventh Edition), the term "auxiliary" is defined as follows: —*
>
> > *"Auxiliary adj. 1. Aiding or supporting. 2. Subsidiary. 3. Supplementary."*

9. As per the assessee, liaison office acts as a communication channel between the Head Office and its customers. Further, liaison office provides support services to its Head Office in Japan and is used for collecting and providing the information about the Indian market as well as for liasioning between the Head Office and the customers. It is the case of the assessee

that liaison office does not carry independent business activities and does not take any business decision. Further, liaison office is dependent on the Head Office and activities carried on by it are only preparatory/auxiliary in nature. We find that the issue as to whether liaison office constitutes PE of the assessee in India has also arisen in the case of the assessee in other assessment years and therefore, before proceeding further, it is relevant to briefly discuss the litigation history of this issue in the case of assessee. At the same time, it is also pertinent to note that the findings on this issue, rendered by the coordinate bench of the Tribunal in assessee's own case in other assessment years, are based only on appreciation of the material and evidence relevant for those years. As noted above, survey action under section 133A of the Act was carried out at the business premises of the liaison office and certain books of account/documents were impounded. Pursuant to the aforesaid survey action, Revenue came to the conclusion that the activities of the liaison office are not confined to preparatory and auxiliary activities, and the liaison office is involved in identifying, negotiating and concluding business contracts in India for and on behalf of its parent office. As a result, the AO, in all the assessment years, considered the liaison office as PE of the assessee in India. On the contrary, it has always been the case of the assessee that the liaison office was involved in only liaison and representative activities and was not involved in any trading or commercial activities to be construed as PE of the assessee in India. Further, as per the assessee, the Head Office had appointed commission

agents in India who are independent entities and the Head Office was also making sales to Indian customers directly.

10. The first order, in the line of decision on this issue, was passed by the coordinate bench of the Tribunal in assessee's own case in Nagase & Co. Ltd. vs ADIT, in ITAs No. 1800/Mum./2007 and 115/Mum./2006, dated 12/01/2017, for assessment year 1998–99, wherein the Co-ordinate Bench, after perusal of performance review report of the staff, agreement entered between third-party and the Head Office, letter amongst assessee's employee and the Head Office, letter from a third party viz. Musk and Fragrance to the liaison office, minutes of meetings etc., as referred to in Para 5.1 of the order came to the conclusion that liaison office does not constitute PE of the assessee in India. The relevant portion of Para-5.1 of the order is as under:-

> *"5.1 .....*
>
> *For that purpose it would be essential to refer to the impounded material. One of the documents relied upon by the AO is PRR of one of the employees. We find that it talks of the performance of one of the employees for the FY. 1998-99 i.e., for the AY. 1999-2000. In our opinion, the report has no relevance for deciding anything for the year under consideration. Now, we would like to analyse the other documents that are relevant for the instant AY. Agreement dtd. 13.09.1996, entered in to between LG Chemicals Ltd. Korea and Nagase & Co.(pg. 517- 22)take of granting non transferable rights to distribute certain chemicals. The agreement was valid up to December, 1996. No other document was referred to by the AO/FAA to prove that the agreement was renewed was acted upon during the year under appeal. Pg. 523 of the PB is a letter from one of the employees of the assessee to its Shanghai office. In that letter the employee has advised the Shanghai office as to how to deal with Indian customers. But, it does not prove that the assessee was indulging in sales activities. A fax message from GS on 15.07.2000 to the HO (Pg.537-39) clearly show that till July, 2000 LO was supposed to find out the 'business possibilities' in the various parts of India. It also talks that intention of the Bombay office was not to do 'independent*

business'. Letter from one of the employees to HO (Pg.546) pertains to some information about purchases to be made as per the 'comments/ order' of the HO. Pg.559 of the PB is a letter from Musk and Fragrance (M&F) to LO. We have not come across any evidence that can prove that LO had directly dealt with the agent. The assessee had claimed that information received from M&F had been forwarded to HO. The AO had not commented upon the assertion made by the assessee. The next document (Pg.567) talks about meeting of members of the LO with agent and one of the manufacturer. It does not prove that the LO was carrying out business activities."

The coordinate bench of Tribunal, in the aforesaid decision, also noted that absence of any action by the RBI strengthens the case of the assessee, as it was alleged by the AO, in that year, that he would inform the RBI about the violations made by the liaison office in conducting its activities.

11. In the next decision, the coordinate bench of the Tribunal in assessee's own case in M/s Nagase & Co Ltd. vs DDIT, ITA No.4654/Mum./ 2010, vide order dated 30/11/2017, for assessment year 2007–08 held that no document has been referred by the lower authorities to prove that transaction entered into by the liaison office establish the fact of existence of business connection of the assessee in India. The Co-ordinate Bench also held that there was no business connection of the assessee in India and there is no evidence that can lead to the conclusion that liaison office was executing the agreements independently with the customers.

12. In another decision, the coordinate bench of the Tribunal in assessee's own case in Nagase & Co Ltd. vs DDIT, in ITA No. 134/Mum./2009 etc., for assessment years 1996–97, 1997–98, 2005–06 and 2006–07, vide order dated 27/04/2018, inter-alia, after considering the document i.e. letter of

M/s Musk and Fragrance addressed to the liaison office, in respect of appeal for assessment year 1996–97, held that the document does not indicate any business activity been carried out by the liaison office in India. The relevant findings of the coordinate bench of the Tribunal in aforesaid decision, in this regard, are as under:

> *"24. We have carefully considered the rival submissions. Factually speaking, quo the previous year relevant to the assessment year under consideration, the only evidence relied upon by the CIT(A) to hold that the LO was directly involved in the business activity by taking help of commission agents is the communication dated 28.09.1995 of M/s. Musk & Fragrance Understandably, M/s. Musk & Fragrance is an independent Commission agent appointed by the Head Office and to that extent, there is no dispute. The claim of the Revenue is that the said communication shows direct business dealings between the LO and the said agent. In this background, we have perused the contents of the said communication, a copy of which has been placed in the Paper Book at page 271. The said communication is with regard to certain product 'Citral' which is explained to be used in the perfumery industry. The communication gives information about the current demand, customer-wise and the present prices of the product. It also refers to certain fax already sent regarding indent of a product. Much has been made before us of the words "If we delay in offering we hope we will loose the market which is developed after putting lot many efforts." appearing in the said communication to say that the LO was involved in business activity. In our considered opinion, the document does not indicate that the LO has carried out any business activity and, in fact, the assertion of the assessee has all along been that the said document has been merely forwarded to the Head Office on the request of the concerned agent."*

13. The coordinate bench of the Tribunal in another decision rendered in the immediately preceding assessment year i.e. 2002–03, in assessee's own case in Nagase & Co Ltd. vs ADIT, in ITAs No. 119 and 368/Mum/2006, vide order dated 22/02/2019, decided the issue of existence of PE in favour of the assessee, by observing as under:

> *"11. ..... After going through the entire gamut of the factual aspect concerning the impugned addition, it is noticed that the impounded documents which could be having a remote connection with the impugned*

assessment year are two communications from M/s Musk and Fragrance, an independent agent of the assessee in India. These communications dated 2nd December 2002 and 21st August 2002 are placed at Page–277 and 278 of the paper book. The communication dated 2nd December 2002 depicts the achievement of sales target for the period 2001–02 and 2002–03. In fact, this communication is an agenda for a meeting arranged for one Mr. Kazuhiko Ijarashi, from the Tokyo Head Office of the assessee company and the representative of M/s Musk and Fragrance. Incidentally, some of the employees of the Liaison Office also attended the meeting held from 4th December to 7th December 2002. The next impounded document pertaining to the impugned assessment year is letter dated 21st August 2002, of M/s Musk and Fragrance to the Liaison Office at Mumbai. A perusal of the said letter indicates that it pertains to the sharing of demurrage charges and reduction of commission to 0.5% with reference to certain invoices raised for the period 2002–03 and 2003–04. On a perusal of the aforesaid impounded documents, we are unable to find any clue to conclude that they establish the involvement of the Liaison Office at Bombay in carrying on any commercial activity on behalf of the Head Office. The contention of the assessee that the presence of the employees / officers of the Liaison Office at Mumbai in the meeting between the representative of the Head Office and M/s Musk and Fragrance was only for establishing a communication channel, since, the representative of the Head Office did not know any other language except Japanese. The other impounded documents specifically referred to by the Assessing Officer and the learned Commissioner (Appeals) in no way conclusively establishes the fact that the Liaison Office at Mumbai was acting as an agent by involving itself in concluding contracts on behalf of the Head Office or involving itself in any commercial transaction on behalf of the Head Office to constitute a PE in India."

14. Thus, the coordinate benches of the Tribunal, vide aforesaid decisions, after examining the documents/evidence pertaining to the assessment year under consideration have held that liaison office does not constitute PE of the assessee in India. Therefore, the question regarding the existence of PE needs to be determined in each and every year on the basis of the facts and circumstances prevailing in that year. During the course of hearing, learned AR referred to the documents impounded during the course of survey under section 133A of the Act pertaining to the year under consideration, which forms part of the paper book from page no. 89 – 109. At this stage, it is also

relevant to note that none of these documents were referred by the lower authorities in their order and liaison office was treated as PE of the assessee in India by merely relying upon the findings in earlier assessment years.

15. The very first document at page No. 89 is a letter dated 15/11/2002, from M/s Musk and Fragrance to the liaison office. In this regard, learned AR submitted that same pertains to the Indian agent through whom sales were made and the agents have complete information about the products in market. In the present case, it has not been disputed that M/s Musk and Fragrance is an independent commission agent appointed by the Head Office. From the perusal of the aforesaid document, we find that the same pertains to product '*Citral*' which appears to be used for aroma chemicals. The said letter provides the information regarding the price of the product in the market and the companies who are biggest manufacturer of this product. In the said letter, M/s Musk and Fragrance also ask the liaison office to seek any further information if required. Thus, we are of the view that said letter is nothing but sharing of information by M/s Musk and Fragrance and same does not indicate that the liaison office was conducting any commercial activity in India. We find that letter regarding similar information from M/s Musk and Fragrance was considered by the coordinate bench of Tribunal in assessee's own case for assessment year 1996–97 (cited supra), wherein the coordinate bench came to the conclusion that the document does not indicate that the liaison office has carried out any business activity in India.

16. At page No. 90 is copy of FAX dated 18/09/2002 by the aforesaid agent to the liaison office, wherein quantity and price of a chemical named 'Linalool' from a company M/s Pharmaco Flavours & Fragrances is mentioned. Further, it is also mentioned that on receipt of confirmation indent will be issued. As per the assessee, the said information was received from the independent agent, which was passed on to the Head Office. Apart from the copy of aforesaid FAX, nothing has been brought on record to prove that indent was sought to be issued on behalf of the liaison office. Thus, we are of the view that this document does not support the case of Revenue.

17. At page No. 91 and 92 of the factual paper book, communication dated 02/12/2002 and 21/08/2002 from M/s Musk and Fragrance are placed. We find that the after considering very same communication, the coordinate bench of the Tribunal in its decision dated 22/02/2019 in assessee's own case (cited supra), held that these documents do not establish the involvement of the liaison office in carrying on any commercial activity on behalf of the Head Office.

18. At page 93, copy of the email communication amongst employee of the liaison office and M/s Nagase (Singapore) is annexed, wherein sale transaction between the Singapore entity and customer viz. Garware is mentioned. From the perusal of the said communication, we find that the same is not relevant for the present appeal as it pertains to another entity of

the assessee in Singapore. Further, the said communication only substantiates the claim of the assessee that the liaison office is merely acting as a conduit for passing the information between the seller and the buyer.

19. At page 94 is another such communication dated 29/01/2003, wherein minutes of meeting between the customer (Divis) and the agent (Transglobe) were sent to the representative of the liaison office, who was present at the meeting, for the purpose of documenting the discussion. Further, the said communication also clearly mentions that the credit facility is dependent on Head Office acceptance. Thus, it is evident that the liaison office has no power to negotiate or decide in any transaction.

20. Further, at page 95 and 96 of the paper book, email communication dated 28/11/2002 between liaison office and Nagase (Europe) GmbH is annexed. From the perusal of the aforesaid email we find that Nagase (Europe) GmbH had provided information to the liaison office regarding product *'Nevamide'* from Navdeep Chemicals to be sold to entity named '*Chukyo'*. The said email was merely forwarded by the liaison office to Mr Shridhar in Navdeep Chemicals. Thus, the same only substantiates the claim of the assessee that liaison office provides support services and acts as a communication channel. Similarly, at page 97 of the factual paper book, is the email communication from one of the customers, which was forwarded by the liaison office to its Head Office. Therefore, the liaison office merely

acted as a communication channel and has not conducted any business activity in this regard.

21. At page 98 and 99 of the factual paper book is an email from employee of the liaison office to its Head Office intimating about the inspection of the factory of supplier of food colours to the Head Office. From the said communication, it is evident that the same refers to the steps taken by the supplier after certain defects were found in its products. We further find that employee of the liaison office also sought suggestions from the Head Office. Therefore, from this document it is evident that no negotiations of business dealings were carried out by the liaison office in this regard.

22. At page 100 of the factual paper book is the email communication between the liaison office and the Head Office. Much has been made before us of the words "*please start to negotiate with the above prices*" appearing in the said communication to say that the liaison office was involved in price negotiations. From the perusal of the said email communication, we find that it refers to collecting the information regarding the pricing of the product in respect of upcoming negotiation with the customers and there is no evidence of any business activity been conducted by the liaison office in India. The email communication at page 101 of the factual paper book, appears to be response from the liaison office to Nagase (Europe) GmbH, in respect of the email correspondence at page 95 and 96 of the paper book. We find that at page 102 of the paper book is the email from the Head

Office which was merely forwarded by the liaison office to the agent in respect of the visit of the representative of the agent to the Head Office in Japan.

23. Page 103–109 of the paper book appears to be the transaction between the supplier in India for the goods required by Nagase Singapore. Thus, from the careful perusal of these documents, we find that the liaison office in India was only providing support services of preparatory and auxiliary in nature and was acting as a communication channel between customers/agent and its Head Office/sister entities. From none of the document it can be concluded that liaison office was engaged in carrying out business activity in India on behalf of the Head Office in Japan.

24. During the course of hearing, learned DR placed reliance upon the decision of Hon'ble Delhi High Court in GE Energy Parts Inc. vs CIT, [2019] 101 taxmann.com 142 (Delhi), wherein after consideration of the material available on record, including documents found during the course of survey action, Hon'ble High Court held that liaison office was carrying core activity of marketing and selling highly sophisticated equipments to US company, and thus liaison office was fixed place P.E. in India. As noted above, while deciding this issue in favour of the assessee in preceding as well as subsequent assessment years, the coordinate bench of the Tribunal clarified that issue of existence of PE needs to be examined in each and every assessment year on the basis of facts relevant to that year. Thus, we are of

the considered opinion that reliance on any decision, be it in the case of the assessee, is of not much relevance unless similar facts and circumstances are shown to exist, when it comes to deciding the issue whether the liaison office constitutes PE within India in any given year. However, nothing has been brought on record, on behalf of the Revenue, to show that the facts and documents as considered by the Hon'ble Delhi High Court, in aforesaid decision, are also available on record in the present case.

25. Further, we find that nothing has been brought on record to suggest that the RBI has found activities of the liaison office as being non-compliant with the terms and conditions of its permission and, therefore, the said aspect supports the assertion of the assessee that liaison office was performing activities as permitted by the RBI, which were preparatory and auxiliary in nature and not the core business activity independent of the Head Office. We also find that apart from the aforesaid documents impounded during the course of survey action, neither statement of the employees of the liaison office or the agents/customers in India was recorded nor any information under section 133 (6) of the Act was sought by the AO in order to support its conclusion that the liaison office constitutes PE of the assessee in India. Further, the Revenue though vehemently submitted that liaison office was negotiating price and doing sales activity in India, however, has not brought any sales agreement in support of the claim. It is highly doubtful that sales transaction of such a large scale can be conducted internationally without any written agreement. Therefore, in view

of aforesaid factual and legal position, we are of considered opinion that the liaison office in Mumbai does not constitute PE of the assessee in India under the provisions of DTAA. Accordingly, ground no. 1 raised in assessee's appeal is allowed.

26. In view of our decision in respect of ground no. 1, issues arising in grounds no. 2 and 3, raised in assessee's appeal, are rendered academic in nature, in the present case. Therefore, grounds no. 2 and 3 are dismissed as infructuous.

27. The issue arising in ground No. 4, raised in assessee's appeal, is pertaining to levy of interest under section 234B of the Act. In view of decision of Hon'ble Supreme Court in DIT v. Mitsubishi Corporation, [2021] 438 ITR 174 (SC), ground No. 4, raised in assessee's appeal, is allowed.

28. In the result, appeal by the assessee is partly allowed.

ITA No. 2312/Mum/2007
Revenue's Appeal- A.Y. 2003-04

29. In its appeal, Revenue has following grounds:

> *"1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in estimating the profits at the rate of 4.29% as against 10% determined by the Assessing Officer by holding that the assessee has worked out India Specific profits correctly whereas during the assessment proceedings assessee stated that it is not possible to ascertain the proper income pertaining to P.E.*
>
> *2 On the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in allowing a deduction of expenses amounting to Rs.1.32 crores by holding that the said expenses were met out for the purpose of business carried out by the P.E. in India.*

3. The appellant prays that the order of the Ld.CIT(A) on the above grounds be set aside and that of the AO restored."

30. The issues arising in Revenue's appeal pertains to the partial relief granted by the learned CIT(A) in respect of computation of taxable profit and allowance of expenditure. Since, the principal plea of the assessee that the liaison office does not constitute PE in India has been upheld in its appeal, therefore, the grounds raised in Revenue's appeal are rendered academic in nature, in the present case. Accordingly, all the grounds, raised in Revenue's appeal, are dismissed as infructuous.

31. In the result, appeal by the Revenue is dismissed.

32. Now, we may take up for consideration the cross appeals filed by the assessee and the Revenue for assessment year 2001-02 against the common impugned order dated 31/10/2005 passed by the learned CIT(A) – 33, Mumbai for assessment years 1996–97 to 2002–03, which, inter-alia, in turn has arisen from the assessment order dated 30/03/2004 passed by the AO under section 143(3) r/w section 147 of the Act.

ITA No. 118/Mum/2006
Assessee's Appeal- A.Y. 2001-02

33. In this appeal, the assessee has raised following grounds:

"Based on the facts and circumstances of the case, Nagase and Company Limited, Japan (hereinafter referred to as the "Appellant') craves leave to prefer an appeal against the order passed by the learned Commissioner of Income-tax (Appeals)-XXXIII, Mumbai [hereinafter referred to as the "learned CIT(A)] under section 250 of the Income-tax Act, 1961 (hereinafter referred to as the 'Act') in respect of the order passed by the Assistant

Director of Income-Tax, International Taxation-Range 3(1), Mumbai (hereinafter referred to as the 'learned AO) under section 143(3) read with section 147 of the Act, on the following grounds:

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

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

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

4. Without prejudice to grounds 1 to 3 above, the learned CIT(A) has erred in not accepting the principle that the profits attributable to the Permanent Establishment, if any, should be computed in accordance with Article 7(1) and 7(2) of the India-Japan tax treaty, by adopting the average rate of commission paid by the Appellant to its independent agents.

Without prejudice to grounds 1 to 4 above, the learned CIT(A) has erred in not considering the global operating profit ratio of 0.47% (details of which were provided by the Appellant during the course of the appellate proceedings) for computing the profits attributable to the Permanent Establishment in India.

Without prejudice to grounds 1 to 5 above, the learned CIT(A) has erred in adopting an arbitrary gross profit rate of 8% (under the provisions of Rule 10 of the Income-tax Rules, 1962), for computing the gross profits attributable to the Permanent Establishment in India, and not considering the actual global gross profit margin of 6.4%, details of which were provided by the Appellant during the course of the appellate proceedings.

Without prejudice to grounds 1 to 6 above, the learned CIT(A) has erred in regarding the entire gross profits of the Appellant from sales made in India as attributable and taxable in India. Further, the learned CIT(A) has disregarded the principle laid out in Explanation (1) (a) to Section 9 (1)(1) of the Act that only the profits attributable to operations carried out in India are taxable in India."

34. The issue arising in grounds no. 1 to 3, raised in assessee's appeal, is pertaining to consideration of liaison office as PE of the assessee in India under the DTAA.

35. Since the basic facts of the case have already been mentioned in earlier portion of this order, the same are not repeated for the sake of brevity. For the assessment year under consideration i.e. 2001–02, the original return of income was filed by the assessee on 25/10/2001 declaring nil income. Subsequently, the reassessment proceedings were initiated under section 147 of the Act on the basis of documents found during the course of survey action under section 133A at the business premises of the liaison office. In response to notice under section 148 of the Act, the assessee filed return on 28/03/2003 declaring nil income. The AO vide order dated 30/03/2004 passed under section 143(3) r/w section 147 of the Act, after referring to the documents found during the course of survey action, held that liaison office constitutes PE of the assessee in India. The AO treated 10% of the turnover as taxable income under Rule 10 and accordingly, made an addition of Rs 17,11,20,000. In appeal, learned CIT(A), after consideration of remand report from the AO, vide common impugned order dated 31/10/2005 for assessment years 1996–97 to 2002-03 dismissed the appeal filed by the assessee on the ground of existence of PE. Further, learned CIT(A) granted partial relief to the assessee and directed the AO to adopt gross profit rate at 8% and allowied the expenditure incurred by the assessee on actual basis. Being aggrieved, both assessee and Revenue are in appeal before us.

36. During the course of hearing, learned AR by referring to the impounded documents found during the course of survey action made the

similar submissions as were made in appeal for assessment year 2003–04. On the other hand, learned DR vehemently relied upon the orders passed by the lower authorities.

37. We have considered the rival submissions and perused the material available on record. Since legal position and litigation history on this issue has already been dealt in the earlier portion of this order, same are also not repeated for the sake of brevity. As noted above the question regarding the existence of PE needs to be determined in each and every year on the basis of the facts and circumstances prevailing in that year. Therefore, the impounded documents relevant for the year under consideration, which forms part of the factual paper book from pages no. 47–75, are dealt hereunder. The very first document at page 47 is a letter dated 20/04/2000 by the employee of liaison office to the Head Office in Japan, wherein information regarding the customer '*Atul*' and products viz. '*DI Ethanol Amine*' and '*Phenol*' are shared with the Head Office. As per the AO, said letter shows that that the liaison office has been assigned by the Head Office to do aggressive marketing. However, upon perusal of the letter we find that same only supports the case of the assessee that the liaison office collects information for being shared with the Head Office.

38. At page 48 is a letter dated 05/06/2000 from the liaison office to one of the customer '*Tyco Electronics*', wherein the liaison office informed the consumer about the discrepancy in the amended letter of credit received

and also new requirement for the order having different quantity from the earlier order. As per the AO, said letter reflects direct dealing by the liaison office. On the other hand, as per the assessee, since it was more expensive for the customer to fax the amended letter of credit to Head Office in Japan, therefore, the liaison office in Mumbai acted as a communication channel with regard to the amendment in the letter of credit. Further, statement "*we have received the above order for 3000 kgs*" is a statement made on behalf of the Head Office. Apart from the aforesaid letter there is nothing available on record to prove either that letter of credit was issued in the name of the liaison office in Mumbai instead of Head Office in Japan or that it was obligation of the liaison office to supply the goods in such large quantity. No agreement in respect of alleged sale transaction is also brought on record by the Revenue. Thus, we are of the view that this letter is another communication sent through the liaison office.

39. At page 49 is a letter dated 19/03/2001 from the Head Office to Mr. Rajani in liaison office, wherein certain instructions were given by the Head Office to the liaison office. This letter supports the case of the assessee that the liaison office was acting as the communication channel and was providing support services to the Head Office.

40. At page 50 is a letter dated 10/08/2000 by Oswal Chemicals to the liaison office in India. As per the AO, said letter reflects direct dealing by the liaison office. On the other hand, it is the submission of the assessee that

the liaison office has merely acted as a communication channel under the instructions and on behalf of the Head Office. Further, the said communication is in respect of a deal which never fructified, since the same was not acceptable to the Head Office. Again, apart from this letter nothing has been brought on record by the Revenue to substantiate the claim that liaison office was performing core business activities in India.

41. At page 51–59 is the performance review report of one of the employee i.e. Mr. Kishore L. Rajani, of the liaison office. In the said performance review report, the employee has submitted to aim for increase in sales of plastic and agrochemical intermediates. The learned DR on the basis of aforesaid statement submitted that the employee cannot propose to do something, which is beyond the scope of its employment. We find that the employee has also stated that he will cater to export business for which he was primarily absorbed. As per the assessee, the performance measurement is the targets achieved by the Head Office on account of the communication or support function played by the employee of the liaison office and same cannot be interpreted to mean that the said employee carry out the actual sales of purchases functions. From the perusal of the said performance review report, we find that there is also a column of sales figure, which is mentioned to be only applicable for sales staff. We find that the said column is left blank. Further there is also no entry in a column for performance for innovation and creation. The employee and his appraiser have evaluated the performance objectives of the employee on the

perimeter of quality, quantity, knowledge of work, planning ability initiative etc. Much has been said about the sales target mentioned in the performance review report, however, there is no document to support the claim of the Revenue that these are the sales figures of the liaison office. Further, no statement of this employee was recorded by the AO nor any information/document was sought under section 133(6) of the Act. There is nothing on record to show that in subsequent years such sales figures were achieved by the liaison office. Therefore, in our considered view, mere reference to the performance review report doesn't substantiate the claim of the Revenue that liaison office is the PE of the assessee in India.

42. The communication at page No. 60 is dated 30/03/2000, and therefore is not relevant for the year under consideration. Further, at page 61–63 is a PVA report dated 20/06/2000. In the report, it has been stated that liaison office should do active marketing investment except for existing customers. Further, it is stated that the liaison office should involve more in actual business activity, instead of merely acting as tour guide or as an escort. The statements made in the aforesaid PVA report appear to be mere suggestions. Nothing has been brought on record to show that these suggestions were actually implemented by the liaison office in this year or subsequent. We are further of the considered view that all the suggestions in the PVA report runs contrary to the permission granted by the RBI and thus the moment the suggestions will be implemented the liaison office will be at risk of losing its license issued by RBI. Further, at the same time this

report substantiates the claim of the assessee that at the moment liaison office is acting as tour guide or as an escort.

43. At page no. 70 is a minute of meeting amongst employees of liaison office and Directors of Yes Fashion Private Ltd. The meeting was also attended by one Mr Jani, who is an employee of Associated Agencies, an independent agent. From the document, it is evident that same pertains to some product and price negotiation. However, it cannot be said that employees of the liaison office was involved in price negotiation. There is no doubt that 2 employees of liaison office were part of the meeting, however, no question was ever asked to them about the duties assigned to them or about the responsibilities shared by them. Further no statement of these employees was recorded by the AO nor any information / document was sought under section 133(6) of the Act.

44. The document at page 71 – 73 also does not substantiate the claim of the Revenue that the liaison office was involved in conducting business activity in India. The document reference to a statement by Mr Yasui that "*Bombay office wishes to do direct business without agent..*". However, nothing has been brought on record to support such a claim and statement also appears to be some future plan of the liaison office, which is irrelevant for the year under consideration.

45. The learned DR, during the course of hearing, placed reliance upon the document at page No. 74 of the paper book to submit that liaison office was

involved in marketing and selling activities in India. From the perusal of the said document we find that same appears to be regarding the communication with entity '*Mangalam*' for a product which is required by the customer and in that regard information about the price was sought. Thus, we are of the considered view that this document supports the claim of the assessee that it acts as mere communication channel.

46. The last document at page No. 75 is the minutes of meeting amongst employees of the liaison office, Mr. Jani, who is an employee of Associated Agencies, and Mr. Gothmare, Manager Materials. There is nothing in the document to show that the liaison office was involved in negotiating the price or was doing any business activity apart from providing the support services.

47. Thus, from the careful perusal of these documents, we find that the liaison office in India was only providing support services of preparatory and auxiliary in nature and was acting as a communication channel between customers/agent and its Head Office/sister entities. From none of the document it can be concluded that liaison office was engaged in carrying out commercial activity in India on behalf of the Head Office in Japan.

48. Further, in this assessment year also, we find that nothing has been brought on record to suggest that the RBI has found activities of the liaison office as being non-compliant with the terms and conditions of its permission and, therefore, the said aspect supports the assertion of the assessee that

liaison office was performing activities as permitted by the RBI, which were preparatory and auxiliary in nature and not the core business activity independent of the Head Office. As noted above, apart from the aforesaid documents impounded during the course of survey action, neither statement of the employees of the liaison office or the agents/customers in India was recorded nor any information under section 133 (6) of the Act was sought by the AO in order to support its conclusion that the liaison office constitutes PE of the assessee in India. Further, the Revenue though vehemently submitted that liaison office was negotiating price and doing sales activity in India, however, has not brought any sales agreement in support of the claim. Therefore, in view of aforesaid factual and legal position, we are of considered opinion that the liaison office in Mumbai does not constitute PE of the assessee in India under the provisions of DTAA. Accordingly, grounds no. 1 to 3 raised in assessee's appeal is allowed.

49. In view of our decision rendered in respect of grounds no. 1 to 3, issues arising in grounds no. 4 to 8, raised in assessee's appeal, are rendered academic in nature, in the present case. Therefore, grounds no. 4 to 8 are dismissed as infructuous.

50. In the result, appeal by the assessee is partly allowed.

ITA No. 343/Mum/2006
Revenue's Appeal- A.Y. 2001-02

51. In its appeal, Revenue has following grounds:

"1. On the facts and circumstances of the case and in law, the Ld. CIT(A) has erred in directing to adopt the sales figures for all the assessment years i.e.A. Yrs. 1996-97 to 2002-03 except A.Y 1999-2000 & 2000-01 as per certified exhibits submitted by assessee, ignoring facts that assessee failed to file global accounts and adopting shifting stands with the filing of revised certified copies of accounts & documents every now and then. The department can rely on impounded documents for estimation of sales,

2. On the facts and circumstances of the case and in law, the Ld.CIT(A) has erred in directing to adopt the gross profit at 8% and expenditure incurred on actual basis, which is without any basis as against AO estimated profit attributable to PE under Rule 10 of the I.T. Act. Whereas, CIT(A) in his order para 9.8 wherein, it is stated that am in agreement with the AO's views that verification of accounts is not possible in the absence of various details like itemwise details of sales, purchases expenses and GP thereof. All accounts filed by the Appellant are merely extracts of its annual accounts. Even certified statements reflecting the summary of financial data is also an extracts from the Fact Books of the Appellant, which does not give a complete state of affairs. Under such circumstances, the AO did not have any option but to estimate the profits attributable to PE under Rule 10 of the I.T. Act, 1961.

3. On the facts and circumstances of the case and in law, the Ld.CIT(A) has erred in deleting the interest u/s 234B of the Act levied by the AO for short payment of advance tax.

4. The appellant prays that the order of the Ld.CIT(A) on the above grounds be set aside and that of the AO restored. 5. The appellant craves leave to amend or alter any ground or add a new ground which may be necessary."

52. The issues arising in Revenue's appeal pertains to the partial relief granted by the learned CIT(A) in respect of computation of taxable profit and allowance of expenditure. Since, the principal plea of the assessee that the liaison office does not constitute PE in India has been upheld in its appeal, therefore, the grounds raised in Revenue's appeal are rendered academic in nature, in the present case. Accordingly, all the grounds, raised in Revenue's appeal, are dismissed as infructuous.

53. In the result, appeal by the Revenue is dismissed.

ITA No. 1803/Mum/2007
Assessee's Appeal – A.Y.2001 – 02

54. This appeal is filed by the assessee against the order dated 30/11/2006 passed by the learned CIT(A) – 33, Mumbai under section 250 of the Act, which in turn has arisen from the order dated 27/02/2006 passed by the AO under section 143(3) r/w section 250 of the Act giving effect to the order of the learned CIT(A) dated 31/10/2005.

55. Since, this appeal arises out of the order giving effect passed by the AO, in view of our decision in ITA No. 118/Mum/2006, hereinabove, this appeal has become infructuous and therefore, is dismissed.

56. To sum up, appeals by the assessee being ITAs No. 1805/Mum./2007 and 118/Mum./2006 are partly allowed, while assessee's appeal being ITA No. 1803/Mum./2007 is dismissed. Further, both the appeals by the Revenue being ITAs No. 2312/Mum./2007 and 343/Mum./2006 are dismissed.

Order pronounced in the open Court on 09/09/2022

Sd/-	**Sd/-**
PRASHANT MAHARISHI	**SANDEEP SINGH KARHAIL**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

MUMBAI, DATED: 09/09/2022

Copy of the order forwarded to:

(1) The Assessee;

(2) The Revenue;

(3) The CIT(A);

(4) The CIT, Mumbai City concerned;

(5) The DR, ITAT, Mumbai;

(6) Guard file.

True Copy
By Order

Pradeep J. Chowdhury
Sr. Private Secretary

Assistant Registrar
ITAT, Mumbai