IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "D": NEW DELHI

BEFORE SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER
AND
SHRI KUL BHARAT, JUDICIAL MEMBER

ITA No. 2259/DEL/2022 **[A.Y.: 2018-19]**
AND
ITA No. 2260/DEL/2022 **[A.Y.: 2019-20]**

Hitachi Ltd., Tower B, World Mark 1, Aerocity, Delhi-110037. PAN- AAACH2953A	Vs	ACIT, Circle Int. Tax. 2(1)(1), New Delhi.
APPELLANT		**RESPONDENT**
Assessee represented by	Shri Ajay Vohra, Sr. Adv. & Shri Sharad Mathur, CA	
Department represented by	Shri Vijay Vasanta, Sr. DR	
Date of hearing	29.05.2023	
Date of pronouncement	19.07.2023	

O R D E R

PER KUL BHARAT, JM:

These two appeals, by the assessee, are directed against separate assessment orders dated 20.07.2022 pertaining to the assessment years 2018-19 and 2019-20, passed by the Assessing Officer u/s 143(3) read with section 144C(13) of the Income-tax Act, 1961 (hereinafter referred to as the "Act"). Since common issues are involved for adjudication, both the appeals were heard together and are being disposed of by a consolidated order for the sake of convenience.

2. The assessee in respective years has raised following grounds of appeal:

ITA No. 2259/Del/2022 (A.Y. 2018-19):

> *"1. That in the facts and circumstances of the case and in law, the order of Assistant Commissioner of Income Tax, Circle International Taxation 2(1)(1), New Delhi (ACIT) u/s 143(3) r.w.s. 144C(13) in pursuance of directions issued by Dispute Resolution Panel (DRP) is bad in law and void, being contrary to law and principles of natural justice.*
>
> *2. That the Learned ACIT has erred in assessing and computing Business loss for the year at Rs. 25,68,94,846 as against returned business loss of Rs. 26,19,37,833 thereby making an addition of Rs. 50,42,981/-.*
>
> *3(a) That the Learned ACIT and DRP have, on mere surmise and guesswork, erred in law and on facts in holding that an income of Rs. 50,42,981/- in relation to contracts with DFCCIL for Offshore Supply of equipment, is directly attributable to the assesse's Permanent Establishment (PE) in India and consequently taxable in India.*
>
> *3(b) That the Learned ACIT and DRP have erred on facts and in law in ignoring that the offshore supplies were made from outside India and no part of the activities relating to Offshore supplies were carried out by the assessee in India.*
>
> *3(c) That the learned ACIT and DRP have grossly erred in law and on facts that consideration for sale of equipment from Japan was liable to tax in India on incorrect appreciation of the provisions of the contract, wrong interpretation of the provisions of the Act and DTAA between India and Japan.*
>
> *3(d) That the learned ACIT and DRP have erred in attributing income from Offshore Supplies to the PE in India without identifying any nexus between the offshore supplies and activities performed by the PE in India.*

3(e) That the learned ACIT and DRP have erred in not following the decisions of Hon'ble Supreme Court of India and Jurisdictional High Court in the following cases where on similar facts, it has been held that consideration for supply of Plant & Equipment, from outside India, was not liable to tax in India:

(i) Ishikawajima - Harima Heavy Industries Ltd. - Vs. Director of Income tax, Mumbai (228 ITR 408 SC)

(ii) Director of Income Tax, New Delhi Vs. LG Cables Ltd. (2011) 197 Taxman 51 (Delhi).

(iii) Linde AG, Linde Engineering Division Vs. DDIT (2014) 44 taxmann.com 244 (Delhi).

3(f) That without prejudice, the learned ACIT and DRP have on mere surmise and guesswork erroneously held that the profit attributable to PE in respect of Offshore Supplies is 35% of the profit accruing from Offshore supplies, which is arbitrary, highly excessive and has no rationale whatsoever and is against the principles of attribution as laid down under the provisions of the Act and DTAA between India and Japan.

3(g) That without prejudice, the learned ACIT and DRP have erred in applying group global profitability of 6.87%, which is completely arbitrary, unjustified and thus makes the adjustment illegal.

3(h) That without prejudice, the learned ACIT and DRP have failed to give cognizance to the fact that financials of DFCCIL projects show a loss from operations, thereby indicating that the Offshore Supplies are in any case not taxable.

4. That the learned ACIT has erred in initiating penalty proceedings under section 270A of the Income Tax Act, 1961, provisions of which are not attracted on the facts.

5. That the appeal is within time as the order was received by the assessee on 21.7.2022.

6. That the assessee may be allowed to add, alter, supplement, revise amend grounds as raised hereinabove.

ITA No. 2260/Del/2022 (A.Y. 2019-20):

"1. That in the facts and circumstances of the case and in law, the order of Assistant Commissioner of Income Tax, Circle International Taxation 2(1)(1), New Delhi (ACIT) u/s 143(3) r.w.s. 144C(13) in pursuance of directions issued by Dispute Resolution Panel (DRP) is bad in law and void, being contrary to law and principles of natural justice.

2. That the Learned ACIT has erred in adding an amount of Rs. 90,55,226/- to the returned income thereby reducing the amount of Business loss to be carried forward in comparison to the amount claimed in the return of income filed by the assessee.

3(a) That the Learned ACIT and DRP have, on mere surmise and guesswork, erred in law and on facts in holding that an income of Rs. 90,55,226/- in relation to contracts with DFCCIL for Offshore Supply of equipment, is directly attributable to the assessee's Permanent Establishment (PE) in India and consequently taxable in India.

3(b) That the Learned ACIT and DRP have erred on facts and in law in ignoring that the offshore supplies were made from outside India and no part of the activities relating to Offshore supplies were carried out by the assessee in India.

3(c) That the learned ACIT and DRP have grossly erred in law and on facts that consideration for sale of equipment from Japan was liable to tax in India on incorrect appreciation of the provisions of the contract, wrong interpretation of the provisions of the Act and DTAA between India and Japan.

3(d) That the learned ACIT and DRP have erred in attributing income from Offshore Supplies to the PE in India without identifying any nexus between the offshore supplies and activities performed by the PE in India.

3(e) That the learned ACIT and DRP have erred in not following the decisions of Hon'ble Supreme Court of India and Jurisdictional High Court in the following cases where on similar facts, it has been held that *consideration for supply of Plant & Equipment, from outside India, was not liable to tax in India:*

> *(i) Ishikawajima - Harima Heavy Industries Ltd. - Vs. Director of Income tax, Mumbai (228 ITR 408 SC)*
> *(ii) Director of Income Tax, New Delhi Vs. LG Cables Ltd. (2011) 197 Taxman 51 (Delhi).*
> *(iii) Linde AG, Linde Engineering Division Vs. DDIT (2014) 44 taxmann.com 244 (Delhi).*

3(f) That without prejudice, the learned ACIT and DRP have on mere surmise and guesswork erroneously held that the profit attributable to PE in respect of Offshore Supplies is 35% of the profit accruing from Offshore supplies, which is arbitrary, highly excessive and has no rationale whatsoever and is against the principles of attribution as laid down under the provisions of the Act and DTAA between India and Japan.

3(g) That without prejudice, the learned ACIT and DRP have erred in applying group global profitability of 6.87%, which is completely arbitrary, unjustified and thus makes the adjustment illegal.

3(h) That without prejudice, the learned ACIT and DRP have failed to give cognizance to the fact that financials of DFCCIL projects show a loss from operations, thereby indicating that the Offshore Supplies are in any case not taxable.

4. That the learned ACIT has erred in initiating penalty proceedings under section 270A of the Income Tax Act, 1961, provisions of which are not attracted on the facts.

5. That the appeal is within time as the order was received by the assessee on 20.7.2022.

6. That the assessee may be allowed to add, alter, supplement, revise amend grounds as raised hereinabove."

3. Facts giving rise to the present appeal are that the assessee filed its return of income for the assessment year under appeal declaring total income of Rs.

45,27,08,220/-. The case was selected for complete scrutiny. In response to the statutory notices issued by the Assessing Officer (AO), the assessee filed the reply regarding details of off-shore supply made by the assessee during the year under consideration. After considering the submissions of the assessee the AO passed a draft assessment order, whereby he proposed addition of Rs. 50,42,987/- to the returned income. Aggrieved against this the assessee preferred its objections before the learned Dispute Resolution Panel ("DRP" in short), who after considering the objections of the assessee, issued certain directions. However, the proposal regarding profit attributable to the India PE @ 35% as computed at Rs. 50,42,987/- was confirmed by the learned DRP. Thereafter the AO passed the impugned assessment order.

4. Apropos to the grounds of appeal learned counsel for the assessee has filed written submissions. For the sake of clarity the submissions of the assessee are reproduced as under:

"1. Facts of the case

1.1 The assessee, Hitachi Ltd. is a Japanese multinational engineering and electronics conglomerate company, headquartered in Chiyoda, Tokyo, Japan. It is one of the largest electronic companies in the world. Hitachi, Ltd. is the parent company of Hitachi Group which operates through several business segments including Social Infrastructure & Industrial Systems having Rail Systems Business Unit as part of the segment.

1.2 The income of the assessee, taxable in India for the relevant year, primarily consists of 'Income from Royalty and Fees for technical services (FTS)' and 'Business Income'.

1.3 Income from Royalty and Fees for technical services comprises of *income earned from various Indian customers under technical collaboration agreements for last many years*

1.4 Business Income comprises of income from various projects under execution with several Indian customers in the Power sector and Railways, including projects with Dedicated Freight Corridor Corporation of India Ltd. (DFCCIL), Ministry of Railways. The assessee has reported its income from performance of Onshore activities relating to the projects through 9 Project offices and 1 branch office which are considered as PE and profits added to the total business income earned in India.

1.5 The basis of taxation has been accepted by the tax department in all earlier years.

1.6 Hitachi Ltd was awarded two new contracts for Rail business by DFCCIL (i) WDFC P-5 Project as part of S.A.F.E. Consortium for Design and construction of Signal and Telecom Works for double line railway involving Train Detection System, Electronic interlocking in stations, Automatic Signalling in Block Sections, Train Monitoring and Diagnostic systems as well as all related equipment, peripherals and works (ii) WDFC P-5A project as part of I.N. Signal Consortium for Design and Construction of Train Protection & Warning System including testing & commissioning.

The scope of work underthe above two contracts awarded by DFCCIL inter alia included <u>Offshore portion for manufacture and supply from Japan</u> and Onshore Portion for indigenous procurement and supplies as well as various Onshore services in India. While the price in respect of Offshore Portion is separately identified and payable in Yen & USD directly to Hitachi Ltd in Japan, the price in respect of Onshore Portion is payable in Indian Rupees and Yen in India. <u>The assessee has offered the entire amount receivable under Onshore portion of the contract to tax in India and paid tax on NetProfit basis</u>. The Offshore portion for supplies made from outside India are not offered to tax in India as the same relates to supply of goods manufactured in Japan and no part of the activity is attributable to the operations of the PEs in India.

2. Additions made by Learned AO in the assessment order

2.1 The Learned AO, while framing the Assessment Order, made additions to total taxable income of the assessee amounting to Rs. 50,42,987 in AY 2018-19 and Rs. 90,55,2267- in AY 2019-20, by attributing 35% of the Offshore Portion to the PE in India. Further Global profit rate of Hitachi

Ltd pertaining to AY 2018-19 (6.87%) was considered as profit from operations to arrive at taxable income of both the years. It may be noted that the income from onshore supply and onshore services were already offered for taxation by the assessee as Business Income.

We would like to bring before your kind notice that the Learned AO, in his order, has not given any basis for attributing part of the Offshore Portion relating to supplies from outside India to the PE in India. The rate of attribution as well as the rate of profit thereon is arbitrarily decided by the Learned AO.

3 Contentions of the assessee

3.1 The Offshore portion of the contract relates to supply of equipment manufactured by Hitachi, Ltd., at their manufacturing facility in Japan. As per the contract terms, Hitachi Ltd. delivered the equipment outside India to Mitsui & Co. Ltd., up to storage at seaport or Airport in Japan, who took delivery ex-works Japan. Mitsui & Co. Ltd. is the transporter and shipper of the goods and was directly paid by the customer DFCCIL for its shipping and transportation activities. After collection of equipment from Hitachi Ltd., Japan, Mitsui & Co. Ltd. shipped the equipment to India and delivered the goods at site in India.

Custom clearance of Offshore equipment supplied is responsibility of Hitachi Ltd.-

Indian Project Offices, howeverall activities in relation to the same are carried out by Mitsui & Co. Ltd. and goods are only passed through the Project Offices for the purpose of Customs duty compliance in India including payment of Customs Duty and IGST, which in turn is charged back to Hitachi Ltd Japan by the Project office. The activities relating to Customs clearance are covered under the scope of work for Onshore portion of the contract.

Accordingly, as per the terms of the contract with DFCCIL, the Offshore goods supplied from Japan were handed over to Mitsui & Co. Ltd. in Japan for transportation and delivery at site, thus no activity in respect of Offshore portion of the Contract is attributable to the PEs of assessee in India.

3.2 As per the DTA between India and Japan, Article 7 deals with Business Profits. As per clause 1 of the Article "the Profits of an enterprise of a contracting state shall be taxable only in that contracting state unless *the enterprise carries on business in the other contracting state through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in that other Contracting state but only so much of them as is directly or indirectly attributable to that Permanent Establishment."*

The Protocol to the DTA delineates the terminology 'directly or indirectly attributable' to the PE, as referred in para 1 of Article 7 as under:

".....With reference to paragraph 1 of article 7 of the Convention, it is understood that by using the term 'directly or indirectly attributable to the permanent establishment', profits arising from transactions in which the permanent establishment has been involved shall be regarded as attributable to the permanent establishment to the extent appropriate to the part played by the permanent establishment in those transactions. It is also understood that profits shall be regarded as attributable to the permanent establishment to the above-mentioned extent, even when the contract or order relating to the sale or provision of goods or services in question is made or placed directly with the overseas head office of the enterprise rather than with the permanent establishment...."

The DTA read with its Protocol makes it amply clear that direct and indirect attribution of profits to the PE refer to involvement of the PE in those transactions. Therefore, where the PE of the assessee is not involved in manufacturing or procurement of the offshore supplies, there can be no question of attribution of any profit arising thereon on the Indian PEs. Following the Doctrine of Territorial Nexus, the profits arising from offshore supplies should not result in any profit attribution to India through the assessee's PEs in India.

3.3 Without prejudice to the above, the assessee had concluded and provided relevant workings, that Offshore Portion of the contract is already a loss at operational level. The loss for Offshore portion is arising on account of the following reasons:

a. Change in product specification by client resulting in rejections and reworking in Japan;

b. Due to changes in labour cost in Japan, manufacturing cost has gone up substantially;

c. Due to delay in project and extensions on account of Covid, the fixed cost has substantially increased.

In that view of the matter, no profit on offshore supplies can, in any case, be attributed to the PE, as held by the Hon'ble Delhi High Court in the case of Commissioner of Income - Tax(lnternational Taxation) v. Nokia Solutions and Networks OY (2023) 147 Taxmann.com 165 (Delhi) (copy enclosed herewith).

3.4 Further, without prejudice to the above, an arbitrary rate of 35% of Offshore Income has been applied as attribution of profits to the Indian PEs without stating any reasons for doing so. It may be noted that the Indian Project Offices of the assessee have merely undertaken assistance in custom clearances of the goods supplied from outside India on behalf of its Head Office. The custom duty and other levies paid by the Indian PEs have been claimed back from the Head Office. The provision of services for custom clearances is part of the onshore portion of the Contract with DFCCIL, profit wherefrom have already been offered to tax and assessed as such in the completed assessment under section 143(3) of the Act.

Lastly, without prejudice to the aforesaid submission that no profit on Offshore supplies can be attributed to the PE in the form of project office(s) in view of (i) goods being manufactured in Japan; (ii) goods being handed over to the Mitsui in Japan for transportation and handling; (iii) Mitsui being separately paid for transportation, logistics and custom clearance; (iv) the project office being importer only in name and payment of custom duty being charged back to the head office; (v) the project office being compensated for undertaking custom clearance formalities; (vi) the project office having being subjected to tax in India on the activities undertaken related to onshore supplies and services, including custom clearance, it is submitted that the notional profit of 6.87% and attribution of 35% thereof is, in any case, excessive and unjustified."

5. Further, learned counsel for the assessee placed strong reliance on the decision of the Hon'ble Delhi High Court rendered in the case of CIT (International Taxation) Vs. Nokia Solutions and Net Works OY [2023] 147 taxmann.com 165 (Delhi)]. He contended that in view of the decision of the

Hon'ble Delhi High Court, no addition could have been made as no profit on offshore supplies can, in any case, be attributed to the PE as offshore portion of the contract is already a loss at operational level. Moreover, the lower authorities failed to appreciate the fact that the Project Office had no activity in respect of the transaction in question. The only activity of Project Office was to the extent of customs clearance. Even otherwise also the attribution of profit is highly excessive which cannot be sustained.]

6. On the other hand, learned DR supported the orders of the lower authorities and submitted that there is no dispute with regard to the fact that the assessee has PE in the form of multiple Project Offices for which these offshore supply of equipment are made, hence there is nothing wrong to attribute revenue from offshore supply as directly attributable to the PE.

7. We have heard rival contentions and perused the material available on record. We find that the objection of the assessee regarding attribution of profit to PE was rejected by the learned DRP by observing as under:

> *"3.3.2 The Panel has considered the submission. The submission f the assessee has been duly considered but not found tenable. The AO in his order at para 6 & 7 has noted that the assessee does not make any offshore supply of goods to India. Instead, it is handed over to its transporter and shipper, M/s Mitsui & Co. M/s Mitsui & Co. receives payment from the customer of Hitachi, DFCCIL, for its shipping and transportation activities. After collection of equipment from Hitachi Ltd., Mitsui then ships the equipment to India and deliver the goods on site in India. The AO has also*

noted that during the year under consideration, the assessee through its transporter and shipper, M/s Mitsui & Co. made offshore supply of Rs. 10,57,98,128/- for one project and Rs. 10,39,33,100/-, totaling to Rs. 20,97,31,228/- for the year. The AO has also recorded a finding that the assessee has PE in the form of multiple project offices, for which this offshore supply of equipment are made and accordingly, the revenue from offshore supply is directly attributable to the PE. Since the manufacturing activity for which equipment supplied is carried out from outside India, therefore only 35% of the profits from offshore supply is considered to be attributable to the PE in India and chargeable to tax @ 40% (excluding surcharge and cess). Considering the global profitability of 6.87%, he calculated the profit from offshore supply at Rs. 1,44,08,535/-. Further, the profit attributable to the India PE @ 35% was computed at Rs. 50,42,987/-. The Panel, therefore, finds no infirmity in the order of the AO and the same is confirmed."

7.1. We find that the objection of the assessee against attribution of profit is three fold. Firstly, that the transaction was effected offshore and the Project Office merely acted for custom clearance. The goods were handed over to the transporter at Japan which was directly paid for its services by the customer DFCCIL for its shipping and transportation activities. After collection of equipment from Hitachi Ltd., Japan, Mitsui Co. Ltd. shipped the equipment to India and delivered the goods at site in India. Though custom clearance of offshore equipment supply was the responsibility of Hitachi Ltd. Indian Project Office, however, all activities in relation to the same are carried out by M/s Mitsui & Co. Ltd. and goods are only passed through the Project Offices for the purpose of customs duty compliance in India including payment of customs duty and IGST, which in turn was charged back to Hitachi Ltd. Japan by the Project Office. The activities relating to customs clearance are covered under the scope of work for Onshore portion of the contract. Hence, as per the terms of contract with DFCCIL, the offshore goods supplied from Japan were handed over to M/s Mitsui & Co. Ltd. in Japan for transportation and delivery at site. Thus, no activity in respect of offshore portion of the contract is attributable to the PEs of assessee in India.

7.2. We have given our thoughtful consideration to the material available on record. The Revenue has not disputed the fact that the equipment was manufactured in Japan, transported to Mitsui & Co. Ltd. and were delivered to the client. Now the moot question that arises is the role of the Project Office. Lower authorities have not specified the role of the Project Office. What was the role of the Project Office for the transaction in question and what is the basis for attributing the profit at 35% to the PE. Moreover, before AO it was stated by the assessee company that the goods were passed through the Project Offices purely for the purpose of customs duty compliances. The lower authorities have not adverted anything on this aspect. Further, the assessee has stated that on account of loss no profit could be attributed. In this regard the assessee placed reliance on the judgment of the Hon'ble Delhi High Court in the case of CIT (International Taxation) Vs. Nokia Solutions and Net Works OY (supra), wherein the Hon'ble Court has held as under:

“10. We may note, that the impugned order passed by the Tribunal has proceeded on the basis, albeit on a demurrer, that the respondent/assessee has a Permanent Establishment [“PE”] in India, and thereafter gone on to discuss, as to whether any profits could be attributed to it.

11. The Tribunal has returned a finding of fact, that the respondent/assessee recorded a “global net loss” in the relevant assessment year, and therefore no profit could have possibly been attributed to it.

11.1 A discussion on this aspect is set forth in the following paragraphs of the impugned judgment passed by the Tribunal:

> *“19. The assessee emphatically denies that the Appellant has a P.E. in India. However, without any prejudice to that basic contention, the assessee submitted that even assuming without conceding that the assessee has a P.E in India, no profit or income can at all be attributed to the P.E as the net profit of the assessee is loss and there are no taxable attributable profits available. The AO has incorrectly determined the profits taking into GP into consideration and if the net profit is taken into consideration rightly, then the issue as to whether the assessee has a P.E in India is would end up as an academic issue.*
>
> *20. The attribution of profits (Net Profit) stands covered in favour of the Appellant by the Judgment of the Special Bench in the case of Nokia Corporation for A.Ys 1997-98 and 1998-99 (involving. Same business as carried out by the Appellant) as mentioned in the PB Volume C-page 936, at 949-950 (para 287). The Special Bench held that the Appellant Company's world wide Net Profit margins as per its audited accounts are to be applied for determining the quantum of the income to be attributed to the P.E. The effect being if the Appellant Company is in net loss as per its audited accounts or the calendar years 2009 and 2010, which relate to the present A.Y. 2010-11, there would be no profit or income attributable to the P.L. There are losses in both years as per the audited accounts. PB- Volume A of Compilation page 164, at 169 and page 180 at 185.*
>
> *21. The relevant portion of the said Special Bench Judgment is quoted herein below (page 287 of Volume C, at page 949- 950):*
>
> > *"287 .... Taking all these into consideration, we consider it fair*

> *and reasonable to attribute 20% of the net profit in respect of the Indian sales as the income attributable to the PE:*
>
> *The following steps are involved in computing the income attributable to the PE:*
>
> *First the global sales and the global net profit have to be ascertained. From the accounts presented before us as well as before the Income-tax authorities, the global net profit rate has been ascertained at 10.8% and 16.1% by the CIT (Appeals), to which no objection has been taken by either side. This percentage has to be applied to the Indian· sales and by Indian sales, we mean the total contract price for the equipment as a whole and not the bifurcated price which the Assessing Officer has referred to in the assessment order. This will also be consistent with our view that the software and the hardware constitute one integrated equipment. The resultant figure would be the net profit arising in respect of the Indian sales. Out of this figure of net profit 20% shall be attributed to the PE to cover the three activities mentioned above. The Assessing Officer is directed to compute the income of the PE as directed above."*

22. The revenue appealed before the Hon'ble Delhi High Court against the said Special Bench Judgment and the only ground raised by the Department was with regard to the rate of Net Profit (20%) applied by the Special Bench and not with regard to the method of taking the net profit rate of the foreign enterprise. The revenue department has thus accepted the finding of the Special Bench with regard to the Net Profit margin method and has allowed that finding to become final. The same method of attribution of profits to the P.E, on the basis of the Net Profit rate of the foreign enterprise has been applied by the revenue in the cases of three other assesses who were in the same field of business as the Appellant viz. ZTE, Huawei and Nortel. Each of these assessees was engaged in the supply of telecom equipment to Indian telecom operators. The ITAT order passed in the case of Notel specifically records that in the cases of each of these two assessees, the revenue had adopted the Net Profit rate of the foreign enterprise for determining the amount of profit income which was attributable to each enterprise's respective P.E.

23. Hence, applying the said Special Bench Judgment to the facts of the present case, as the Appellant has globa1 net loss as per its audited accounts, no profit or income can be attributed to the assessee in India.

24. To mention Special Bench ruling is in line with the provisions of Article 7(1) of the India Finland Double Taxation Avoidance Agreement (DTAA), which is set out at page 719, at 723 of Volume B of the Compilation. For the - sake of convenience, Article 7(1) is reproduced hereunder:

> *"1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprises carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.*

25. Article 7(1) thus provides as under: NEUTRAL CITATION NO: 2022/DHC/005483 ITA 503/2022 Page 6 of 8

> *"(a) The profits of an enterprise can ordinarily be taxed only by the country in which it is located.*
>
> *(b) If however, the enterprise has a P.E. located in another country (which is also a signatory to the DTAA), through which it carries on its business, then a portion of its profits, to the extent it is attributable to the P.E. can be taxed in the other country."*

26. On a plain reading of Article 7(1) of the DTAA, the question of attributing profits to the P.E. arises only if the foreign enterprise is making a profit. This is the condition precedent. If it is making a loss then no question arises at all of attributing any profit to the P.E., which would be taxable in India.

27. The Assessing Officer has taken gross profit margins of the Appellant Company for 2009 and 2010 as per its audited accounts instead of the net profit margins. The gross profits margins of the

Appellant Company for 2009 and 2010 were positive, and that was how the A.O. could attribute profits to the P.E. In so adopting the gross profit margins of the Appellant Company, the A.O. has acted in a manner which is directly contrary to Article 7(1) of the DTAA and also contrary to the said Special Bench Judgment. It is the Net Profits margins which are to be considered as for attribution as per the DTAA.

28. The computation made by the A.O. in his assessment order is incorrect as the AO has not allowed the payments made by the Appellant to NSN India for the services rendered by NSN India as a deduction from the profit attributable to the alleged PE. If the said payments are allowed as a deduction from the gross profit figures taken by the A.O., then again the resultant figure would be losses. Consequently, even if the method of attribution adopted by the A.O. is considered to be correct, in any event, there would be no profit/income attributable to the PE. The computation is as under:

Particulars	*Amount (INR)*
Gross Margin of the alleged PE (as determined by the AO)	*6,62,39,89,219*
Less: Deduction for actual payments to NSN India during the relevant A.Y.: *(a) Compensation for network management support* *(b) Compensation for marketing support* *(c) Compensation for R&D Support*	 *1,28,53,61,568* *2,49,01,07,317* *5,60,25,53,834*
Net operating profit/loss of the alleged PE	*(2,75,40,33,500)*

29. Consequently, even if the Appellant has a PE in India, no profit or income can in law at all be attributed to PE which would be taxable in India. Hence, we hold that, the adjudication on issue of PE would be academic in nature."

12. Having regard to the following finding of fact returned by the Tribunal, we are of the view that the proposed questions of law i.e., A and B would not arise for consideration.

13. We may also note, that a plain reading of the Article 7 of the Double Taxation Avoidance Agreement entered into between India and Finland also *persuades us to take the same view as that which is taken by the Tribunal.*

13.1 A plain reading of the Article 7(1) would show, that the issue of taxability would arise qua the respondent/assessee only if profits accrue to the respondent/assessee, and that too only to the extent they can be attributed to its PE in India."

7.3. The Revenue has not brought any contrary material. Therefore, following the binding judgment of the Hon'ble Jurisdictional Delhi High Court rendered in the case of CIT (International Taxation) Vs. Nokia Solutions and Net Works OY (supra), we are of the considered view that the authorities below were not justified in attributing the profit to the assessee when there was loss. We, therefore, direct the Assessing Officer to delete the impugned addition. Grounds raised by the assessee are allowed. The appeal of the assessee is allowed.

8. Facts of the case in assessee's appeal for A.Y. 2019-20 in ITA no. 2260/Del/2022 are identical to the facts of the case in A.Y. 2018-19. Even the parties have also raised same arguments. Therefore, for the very same reasons as given by us in assessee's appeal for A.Y. 2018-19, above, we direct the Assessing Officer to delete the addition. Grounds taken by the assessee are allowed.

9. In the result, assessee's appeals being ITA no. 2259/Del/2022 for A.Y. 2018-19 and ITA no. 2260/Del/2022 for A.Y. 2019-20 stand allowed.

Order pronounced in open court on 19th July, 2023.

Sd/-	**Sd/-**
(SHAMIM YAHYA)	**(KUL BHARAT)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

MP
Copy forwarded to:

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

ASSISTANT REGISTRAR
ITAT, NEW DELHI