

DIRECTOR OF INCOME TAX vs. NOKIA NETWORKS OY

HIGH COURT OF DELHI

A. K. SIKRI, ACJ & REVA KHETRAPAL, J.

ITA nos. 359 of 2005 & 1137, 1138 of 2006 & 503, 505, 506, 512 & 1324 of 2007 & 30 of 2008

7th September, 2012

(2012) 82 CCH 0225 DelHC

(2012) **253 CTR 0417** : (2012) 78 DTR 0041 : (2013) 358 ITR 0259 (Delhi) : (2013) 212 TAXMAN 0068

Legislation Referred to

Section 143(3), 234B, 9(1)(vi), 260A, 19 (Sale of Goods Act), 5(2)(b), 44BB, 90(2)

Case pertains to

Asst. Year 1997-98 and 1998-99

Decision in favour of:

Assessee (Partly)

Income deemed to accrue or arise in India—Software—Royalty—Business connection/Permanent Establishment—Assessee, a company incorporated in Finland was a leading manufacturer of advanced GSM equipment—It maintained a Liaison Office (LO) and also had a subsidiary in India, NIPL—Assessee sold GSM equipment (Hardware as well as software as well as installation and commissioning of the two and also after sale services) manufactured by it in Finland to Indian telecom operators from outside India on a principal to principal basis, under independent buyer-seller arrangements—Installation activities were undertaken by Indian subsidiary under its independent contracts with Indian telecom operators—AO and CIT(A) held that LO and Indian subsidiary constituted assessee's PE in India and part of the revenue was attributable to PE and the whole of software revenue was assessed as "royalty" under s. 9(1)(vii) and Article 13—Tribunal granted partial relief to both assessee and Revenue—Held, LO has not carried out any business activity for the assessee in India, its role has been only to assist assessee in the preliminary and preparatory work—LO has only carried out advertising activity which cannot by any means furnish business connection—Even by law, the LO was prohibited in engaging itself in any business activities in India on behalf of the foreign enterprise, which could be considered to furnish a business connection in India—LO does not constitute assessee's PE in India—Further for taxing the profits for supply of equipment, place of negotiation, the place of signing of agreement or formal acceptance thereof or overall responsibility of the assessee are irrelevant circumstances—Since the transaction relates to the sale of goods, the relevant factor and determinative factor would be as to where the property in the goods passes—In instant case goods were manufactured outside India and even the sale has taken place outside India, property on goods passed on high seas—Supply has to be segregated from the

installation and only then would question of apportionment arise to the determine the extent to which it arises in s. 9(1)(i)—Reliance placed by revenue on retrospective amendment of s. 9 was also misplaced—Assessee opted to be assessed by DTAA, the consideration cannot be assessed as "royalty" despite the retrospective amendments to the Act—In view of decision of Delhi High court in DIT v Ericsson AB, consideration for supply of software was not taxable as 'royalty' either under s. 9(1)(vi) or the relevant provision of the DTAA—Order of the Tribunal that 'NIPL' was a permanent establishment of assessee was based on many factual errors—Matter remitted to AO to consider this issue—Assessee's appeal partly allowed

Held :

Tribunal held that LO has not carried out any business activity for the assessee in India and that its role has been only to assist the assessee in the preliminary and preparatory work. As per the rules of the Reserve Bank of India itself, a LO is not permitted to carry out any business activity for a foreign enterprise. Reserve Bank of India has not found any violation of the rules under which permission has been granted to the LO. The LO no doubt has certain staff who have been paid salary and perquisites but there is no evidence to show that they were transacting any business in India on behalf of the assessee. The LO has only carried out advertising activity which cannot by any means furnish business connection. Even by law, the LO is prohibited in engaging itself in any business activities in India on behalf of the foreign enterprise, which could be considered to furnish a business connection in India. Finding of facts arrived at by the Tribunal are final and cannot be disturbed by the High Court while considering the appeal under s. 260A of the Income Tax Act, 1961 which is only on substantial question of law. Findings of ITAT, on facts were not perverse, thus upheld on this issue. Thus LO cannot be constituted as Permanent Establishment of the assessee in India.

(Para 8, 9)

The income was earned by the assessee as a result of supply of hardware and software licence under the Supply Agreement. If this Supply Agreement is taken as standalone Agreement, the facts on record show that such supplies under this agreement were made overseas. The property in goods had passed on to the buyer under the Supply Contract outside India where the equipment was manufactured. Such agreement would not be taxable in India. IshikawajimaHarinia Heavy Industries Ltd. v. DIT, Mumbai, (2007) 3 SCC 481., relied on.

(Para 13)

S. 19 of the Sale of Goods Act also makes it clear that property in goods passes when the parties intend it to pass and in the present case, the intention of the parties is manifested in Article 13 of the supply contract and the provisions of Article 15 in no manner militate against such intention. Further, there is nothing in the conduct of the parties which would suggest that the express provisions of Article 13 have been given a go-by.

(Para 14)

Issue that the contract was signed in India was held to be not a relevant circumstance to determine the taxability of such an income. Additional CIT, Andhra Pradesh v. Skoda Export, [1983] 143 ITR 452, relied on.

(Para 15)

The terms of contract make it clear that acceptance test is not a material event for passing of 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 the 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 test 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. Mahavir Commercial Company Vs. CIT, 86 ITR 147, relied on.

(Para 17, 18)

Thus, Overall Agreement does not result the income accruing in India. The execution of an overall agreement is prompted by purely commercial considerations as the India Cellular Operator would be desirous of having a single entity that he could liaise with, a fact which even the Board has noted in its Instruction No.1829 dated 21st September, 1989. Although Instruction number 1829 stands withdrawn by virtue of Circular No.7/2008 dated 22nd October, 2009, such withdrawal can have no retrospective effect and the principle laid down in Instruction No. 1829 must continue to govern the assessment for the relevant year.

(Para 19)

Thus the places of negotiation, the place of signing of agreement or formal acceptance thereof or overall responsibility of the assessee are irrelevant circumstances. Since the transaction relates to the sale of goods, the relevant factor and determinative factor would be as to where the property in the goods passes. In the present case, the finding is that property passed on the high seas. In the present case, the goods were manufactured outside India and even the sale has taken place outside India. Once that fact is established, even in those cases where it is one composite contract (though it is not found to be so in the present case) supply has to be segregated from the installation and only then would question of apportionment arise having regard to the expressed language of s. 9 (1) (i) of the Act, which makes the income taxable in India to the extent it arises in India. Commissioner of Income Tax, Meerut and Anr. Vs. Hyundai Heavy Industries Co. Ltd. 291 ITR 482, relied on

(Para 20)

S. 9 has been amended vide Finance Act, 2012 and Explanations have been inserted with retrospective effect from 1-6-1976. The revenue argued that the amendments are only clarificatory in nature and submitted that the question of "copyrighted article" or actual copyright does not arise in the context of software both in the DTAA and in the Income Tax Act since the right to use simpliciter of a software program itself is a part of the copyright in the software irrespective of whether or not a further right to make copies is granted. The decision of the Delhi Bench of the ITAT has dealt with this aspect in its judgment in Gracemac Co. Vs. ADIT 134 TTJ (Delhi) 257 pointing out that even software bought off the shelf, does not constitute a "copyrighted article". It was categorically held in CIT Vs. Siemens Aktiengesellschaft, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty and on the wording of the treaty, it was already held that a copyrighted article does not fall within the purview of Royalty. Gracemac Co. Vs. ADIT 134 TTJ (Delhi) 257, CIT Vs. Siemens Aktiengesellschaft, 310 ITR

320 (Bom), DIT Vs. Ericsson, 343 ITR 370, relied on.

The reasoning given in Ericsson A.B.'s case applies in instant case to instant case as well. 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 undertaken by NIPL undertaken its separate contract with Indian customers. This installation contract has not been entered into between the assessee and Indian Cellular operator. Clause 19.1 of the supply contract between the respondent and Indian Cellular company (Tata) was examined threadbare by the ITAT Special Bench and it was held 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. Thus consideration for supply of software was not taxable as 'royalty' either under s. 9(1)(vi) or the relevant provision of the DTAA.

(Para 29)

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

(Para 38)

Conclusion :

LO of company incorporated in Finland which has not carried out any business activity for the non-resident company in India and its role was only to assist assessee in the preliminary and preparatory work, cannot constitute assessee's PE in India.

Consideration received by company incorporated in Finland for supply of GSM equipment manufactured in Finland to Indian telecom operators from outside India on a principal to principal basis under independent buyer-seller arrangements and installation activities were undertaken by Indian subsidiary under its independent contracts with Indian telecom operators, not taxable as 'royalty' either under s. 9(1)(vi) or the relevant provision of the DTAA.

In favour of :

Assessee (Partly)

Counsel appeared:

Mohan Parasaran, SanjeevSabharwal, AlokPrasanna Kumar, AarthiRajan, N.K. Meyyappan for the Petitioner. : M.S.Syali, HusnalSyali, MayankNagi, AbhimanyuJhamba, Rahul Sateeja for the Respondent.

A. K. SIKRI, ACTING CJ.

1. Some of these appeals filed by the Nokia Network OY (hereinafter referred to as 'the assessee') and some filed by the Director of Income-Tax (hereinafter referred to as 'the Revenue') pertain to assessment year 1997-98 and 1998-99.

2. The assessee, a company incorporated under the laws of Finland, is a leading manufacturer of advanced telecommunication systems and equipment (GSM equipment) which are used in fixed and mobile phone networks. During the previous year relevant to assessment years 1997-98 and 1998-99, Nokia maintained a Liaison Office and also had a subsidiary in India, presently known as Nokia India Private Limited (hereinafter referred to as NIPL). During this period, GSM equipment manufactured in Finland was sold to Indian telecom operators from outside India on a principal to principal basis, under independent buyer-seller arrangements. Installation activities were undertaken by Indian subsidiary under its independent contracts with Indian telecom operators. Nokia, being a taxresident of Finland, is governed by the provisions of India-Finland Double Taxation Avoidance Agreement. Assessment under Section 143 (3) was completed, in the following manner:-

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

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

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

(d) Interest under section 234B of the Act was levied on account of non-payment of advance income-tax.

3. Being aggrieved by the assessment order, an appeal was filed before the CIT (A) who held as under:

(i) True intention of the contract of supply was not merely to supply the equipment but

was also to install and provide related services by or on behalf of Nokia.

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

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

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

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

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

4. As the appeals were partly allowed, both the parties felt aggrieved by the order of CIT(A). Thus, appeals were filed both by Nokia as well as by the Department with the Income-Tax Appellate Tribunal (ITAT). A Special Bench was constituted wherein these appeals were taken up alongwith appeals of Motorola Inc. and Ericsson Radio Systems AB. The key issues before the Special Bench in Nokia appeals were as follows:

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

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

(c) If the answer to Question No. 1 and 2 is in affirmative, what is the income attributable to the PE under Article 7 of the DTAA?

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

(e) Whether any income forming part of the consideration for supply of equipment and licensing of software integral thereto is taxable as 'royalty' under Section 9(1)(vi) of the Income Tax Act, 1961 or Article 13 of the DTAA?

(f) Whether on facts and in law the notional interest on delayed consideration for supply of equipment and licensing of software is taxable in the hands of Nokia?

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

5. The ITAT decided appeals of all the assesseees by a common judgment dated 22.6.2005. In so far as appeals relating to Nokia are concerned, findings of the Special Bench are as under:

(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. HannuKaravirta, 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; and

(c) Signing of supply and installation contracts.

(d) 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).

6. It is clear from the above that certain issues are decided in favour of Nokia and some in favour of the Revenue, by the Special Bench. That is precisely the reason for both by the Revenue and Nokia approaching this Court by filing appeals challenging the respective findings which have gone against them. Gist of the issues raised in the appeals filed by both the parties is tabulated as under:-

Department's appeal		
ITA No.	Assessment Year	Issues
503/2007	1998-99	LO constituted business connection/PE; Taxation of off-shore supply revenues; Supply and installation contracts together constitute 'works contract'; Attribution of profits to alleged PE Royalty; Levy of Interest u/s 234B
505/2007	1997-98	LO constituted business connection/PE; Taxation of off-shore supply revenues Attribution of profits to alleged PE; Royalty; Levy of Interest u/s 234B
506/2007	1997-98	LO constituted business connection/PE; Taxation of off-shore supply revenues; Supply and installation contracts together constitute 'works contract'; Attribution of profits to alleged PE: Royalty Levy of interest u/s 234 B
512/2007	1998-99	LO constituted business connection/PE; Taxation of off-shore supply revenues; Supply and installation contracts together constitute 'works contract'; Attribution of profits to alleged PE; Royalty; Levy of Interest u/s 234B
Nokia' Appeals		
1137/2006	1997-98	NIPL as PE of Nokia; Attribution of profits to alleged PE; Imputed income from vendor financing
1138/2006	1998-99	NIPL as PE of Nokia; Attribution of profits to alleged PE; Imputed income from vendor financing

7. The questions of law on which ITA 512/ 2007 was admitted would cover all the appeals of the Department, and therefore, we are reproducing those questions hereunder:-

"1. 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?

2. 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?

3. 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(1)(vi) or the relevant provision of the DTAA?

4. 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 of the Respondent?

5. Whether on facts and in law interest under Section 234B is leviable?"

QUESTION NO. 1 & 2:

8. First question is about the business connection of the assessee in India through the Liaison Office (LO). The necessary facts for determination of this question are that the assessee had opened this LO in India on 30.3.1994. Two agreements were signed between the assessee on the one hand and Indian Cellular Operators on the other hand viz. ModiTelestra (I) Ltd. and Skycell Communication Ltd. on 23.3.1995 and 17.2.1995 respectively. When these contracts were signed, the assessee subsidiary viz. NIPL was not in existence. As this company was incorporated on 23.5.1995 after that date four other agreements were entered into with different cellular operators. The assessee supplied both the hardware and software to Indian Cellular Operators and its subsidiary namely NIPL carried out installation work. It is in this context the question has arisen about the role of the LO and whether such LO can be said to furnish "business connection" to the assessee in India. We may remark that the second question of law about PE is also on the role of said LO namely whether this LO can be said to constitute a PE in India. Therefore, these two questions become inter connected. The findings which are arrived at by the Tribunal are that the assessee, namely, Nokia Networks OY is a company incorporated in Finland and a tax resident thereof. It opened a liaison office in India on 30.3.1994. Two agreements were signed between the assessee on the one hand and the Indian Cellular Operators on the other hand, namely, ModiTelestra (I) Ltd. and Skycell Communication Ltd. on 23.3.1995 and 17.2.1995 respectively. When these contracts were signed, the assessee's subsidiary i.e. NIPL was not in existence. It was incorporated only later on 23.5.1995. Thereafter, four other agreements were entered into with different cellular operators, namely, Tata, Evergrowth Fascell, BPL and Supreme. The assessee supplied both the hardware and software to the Indian cellular operators and NIPL, its 100% subsidiary carried out installation work. It was on this basis, the Tribunal remarked that the main question to be considered related to the role of the LO, namely, whether LO could be said to furnish "business connections" to the assessee in India and whether this LO could be treated as constituting a PE of the assessee in India. In so far as issue of "business connection" is concerned, finding which is arrived at by the Tribunal is that the LO has not carried out any business activity for the assessee in India and that its role has been only to assist the assessee in the preliminary and preparatory work. It is further found by the ITAT that as per the rules of the Reserve Bank of India itself, a LO is not permitted to carry out any business activity for a foreign enterprise. Its activities are closely monitored by the Reserve Bank of India. Reserve Bank of India has not found any violation of the rules under which permission has been granted to the LO. The LO no doubt has certain staff who have been paid salary and perquisites but there is no evidence to show that they were transacting any

business in India on behalf of the assessee. The LO has only carried out advertising activity which cannot by any means furnish business connection. The Income-tax authorities would appear to have also held that the LO carried out marketing activities for the assessee in India but for this finding, there is no evidence and none of the contracts which have been brought on record indicate that the LO has carried out any marketing activities. The Tribunal, in the process, also noted the findings of CIT (A) as per which the facts and circumstances suggest that the assessee carried out business in India through its LO. However, this finding was not accepted by the Tribunal on the ground that it was not merely preparatory or incidental in nature, there was nothing on record to show that the LO had something to do with designing activity connected to the GSM. According to the Tribunal, the CIT (A) had made a general statement that the assessee always had the presence of its office, without reference to any material or evidence justifying this conclusion. In fact, concluded the Tribunal, even by law, the LO is prohibited in engaging itself in any business activities in India on behalf of the foreign enterprise, which could be considered to furnish a business connection in India. The entire attempt and focus of Mr. Parasaran , learned ASG was on the order passed by the Assessing Officer as well as CIT(A) on the basis of which it was sought to argue that the aforesaid LO constituted business connection. However, this endeavour is only to dislodge the findings of ITAT, on facts. It could not be satisfactorily explained as to how the findings of ITAT were perverse. Finding of facts arrived at by the Tribunal are final and cannot be disturbed by the High Court while considering the appeal under Section 260A of the Income Tax Act, 1961 which is only on substantial question of law. In **Commissioner of Income Tax v. NHK Japan Broadcasting Corporation**, 291 ITR 331, a Division Bench of this Court, after referring to the Supreme Court judgment in **IshwarDass Jain v. SohanLal**, AIR 2000 SC 426 has laid down the law, on this aspect, thus:

"The effect of a concurrent finding has been dealt with in **IshwarDass Jain v. SohanLal**, AIR 2000 SC 426. The Supreme Court noted two situations where findings of fact can be interfered with (though under Section 100 of the Code of Civil Procedure which is admittedly parimateria with Section 260A of the Act). The first situation is when material or relevant evidence is not considered which, if considered, would have led to an opposite conclusion, while the second situation in which interference is permissible is where a finding has been arrived at by placing reliance on inadmissible evidence which if it was omitted, an opposite conclusion was possible. Neither of these two situations arises in the present case. Therefore, on the basis of the decision rendered by the Supreme Court, no substantial question of law would arise on the finding of fact arrived at by the Commissioner and the Tribunal. We may add that no contention is urged that the finding of fact is in any manner perverse, which may warrant interference under Section 260A of the Act."

9. Therefore, on the basis of the aforesaid findings, which are final, it is clear that there is no material or evidence on the basis of which it could be said that the LO can afford a business connection to the assessee in India. For same reasons, we are of the view that LO cannot be constituted as Permanent Establishment of the assessee in India.

10. Knowing this difficulty, the entire thrust of Mr. Parasaran , the learned ASG was that supply contract on the one hand and installation contract with marketing and support agreement on the other hand be treated as one composite agreement. That relates to question no.3 to which we shall revert hereinafter. In so far as these two questions are concerned, they are decided in the negative. The other three agreements namely installation, marketing and supply were within Indian company and taxes have been paid on the income generated from this business. The supply contract was different which was with the assessee who is a foreign company. The supply was made from foreign country. The existence of this equipment was at the assessee's factory before dispatch of

the equipment as is clear from Clause (8) of the said Agreement.

11. In view of our detailed discussion in ITA 504/2007 and other connected matters decided on 23.12.2011, qua Ericsson, these contracts cannot be treated as composite contracts.

12. In order to decide the issue at hand, let us recapitulate some of the salient features. The assessee is a foreign Company. Its activities involved supply of hardware and software as well as installation and commissioning of the two and also after sale services. It entered into agreements with various Cellular Operators and entered into three contracts with them namely (1) Overall Agreement, (2) the Supply Agreement and (3) the Installation Agreement.

13. In the present case, we are concerned with the income earned by the assessee as a result of supply of hardware and software licence under the Supply Agreement. If this Supply Agreement is taken as standalone Agreement, the facts on record show that such supplies under this agreement were made overseas. The property in goods had passed on to the buyer under the Supply Contract outside India where the equipment was manufactured. As per the judgment of Supreme Court in **Ishikawajima Harinia Heavy Industries Ltd. v. DIT, Mumbai**, (2007) 3 SCC 481 such agreement would not be taxable in India. In **Ishikawajima** (supra), the Supreme Court held that no part of profit arising from the supply of equipment outside India would be chargeable to tax in India. The analysis of the present case on the basis of the ratio of **Ishikawajima's** (supra) is right inasmuch as:-

(i) In both the cases the property in the equipment passed outside India and in the assessee's case even the risk passed outside India;

(ii) In the case of **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.

14. We may add that Section 19 of the Sale of Goods Act makes it clear that property in goods passes when the parties intend it to pass and in the present case, the intention of the parties is manifested in Article 13 of the supply contract and the provisions of Article 15 in no manner militate against such intention. Further, there is nothing in the conduct of the parties which would suggest that the express provisions of Article 13 have been given a go-by.

15. No doubt, the contract in question was signed in India. However, that may not be a relevant circumstance to determine the taxability of such an income in view of the judgment of Andhra Pradesh High Court in **Additional CIT, Andhra Pradesh v. Skoda Export**, [1983] 143 ITR 452.

16. We may point out that the learned Additional Solicitor General was conscious of the aforesaid legal position and, therefore, the limitation of Revenue's case if the same was to be determined on the examination of the Supply Contract per se and de hors the Installation Agreement and Overall Agreement. It is for this reason that his line of argument proceeded on the basis that the three agreements are to be taken to form an 'Integrated business arrangement' between the parties which was governed by the Overall Agreement. As noticed above, this submission proceeded on the basis that the assessee had entered into contracts with cellular operators in India for setting up of GSM system in India, the hardware and software for which was supplied by the assessee, and the installation thereof was also over-seen by the assessee who was to ensure that it was carried out to the satisfaction of Indian buyer in accordance with the terms of the contract. Various clauses of Overall Agreement as well as Installation Agreement have been relied upon as already noticed above. Article 15 of the Installation Agreement deals with acceptance test made by the Installation contractor which "includes the integrity of whole system and certificate binds the assessee" Article 17 provides warranties to rectify the defects in both hardware and software provided by the assessee. On this basis it was argued that the Assessing Officer rightly concluded that overall responsibility was on the assessee for supply, erection and after sale services and the assessee had complete control over the management, functions and the associates. The question that falls for consideration is as to whether this acceptance test, which was performed in India, would be relevant for determining as to whether income accrued in India in terms of Section 5 (2)(b) of the Act.

17. We find that the terms of contract make it clear that acceptance test is not a material event for passing of 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 the 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 test 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. In **Skoda Export** (supra), the

Andhra Pradesh High Court dealt with this issue in the following manner:-

"We may also mention that learned standing counsel for the Department challenged the finding of the Tribunal that the sale of machinery was completed outside India; According to him, the sale was completed only in India, inasmuch as the assessee was entitled to inspect and satisfy itself about the quality and standard of the machinery supplied. We do not see any substance in this contention. The various clauses in the agreement referred to above make it clear that the sale of machinery was F. O. B., European port, and the time of fulfillment of delivery was prescribed as the date of the bills of lading. The payment was also to be made outside India. The agreement further makes it clear that the insurance risk during the course of the journey was that of the assessee and it paid for the same : even the freight charges from the European port to the place of destination were paid by the assessee. Thus, judged from any angle, the sale of machinery, which are "goods" within the meaning of the Sale of Goods Act, was completely outside India. A mere provision in the agreement that the assessee is entitled to satisfy itself about the quality and standard of the machinery in India cannot, in the circumstances of this case, detract from the fundamental position that the sale took place outside India. In such a situation, one has to apply the test of predominance and decide where the sale took place ? On a combined reading of the clauses of the agreement, we have no doubt that the sale of machinery did take place outside India."

18. We may also usefully refer to the judgment of the High Court in **Mahavir Commercial Company Vs. CIT**, 86 ITR 147 wherein following principle was enunciated:

"Even though the property in the goods may pass to the buyer when the documents are handed over, the buyer may yet retain the right to examine and repudiate the goods but this right generally which a buyer has in c.i.f. contract does not by itself indicate that the property in the goods has not passed to him. This supposed incongruity was sought to be explained per curiam in **Kwei Tek Chao v. British Traders and Shippers Ltd.** (1954) 2 K.B. 459. that if property passed when the documents are transferred that property is subject to the condition that the goods should re-vest in the seller if on an examination by the buyer he finds them not to be in accordance with the contract. It is not necessary to consider this aspect because in any case the ascertainment of the obligations under the contract will determine to what extent the transfer of property is subject to a condition or if the property passes conditionally whether the ownership left in the seller is the reversionary interest in the property in the event of the conditions subsequent operating to restore it to him. In any case where the performance of some condition is imposed upon the buyer but is not made a condition of the transfer of the property, the property once passed is not re-vested in the seller by the buyer's subsequent default."

19. Thus, Overall Agreement does not result the income accruing in India. The execution of an overall agreement is prompted by purely commercial considerations as the India Cellular Operator would be desirous of having a single entity that he could liaise with, a fact which even the Board has noted in its Instruction No.1829 dated 21st September, 1989. Although Instruction number 1829 stands withdrawn by virtue of Circular No.7/2008 dated 22nd October, 2009, such withdrawal can have no retrospective effect and the principle laid down in Instruction No. 1829 must continue to govern the assessment for the relevant year.

20. The aforesaid analysis will bring forth the legal position that the places of negotiation, the place of signing of agreement or formal acceptance thereof or overall responsibility of the assessee are irrelevant circumstances. Since the transaction relates to the sale of goods, the relevant factor and determinative factor would be as to where the property in the goods passes. In the present case, the finding is that property passed

on the high seas. Concededly, in the present case, the goods were manufactured outside India and even the sale has taken place outside India. Once that fact is established, even in those cases where it is one composite contract (though it is not found to be so in the present case) supply has to be segregated from the installation and only then would question of apportionment arise having regard to the expressed language of Section 9 (1) (i) of the Act, which makes the income taxable in India to the extent it arises in India.

21. It will also be pertinent to refer to the judgment of the Supreme Court in **Commissioner of Income Tax, Meerut and Anr. Vs. Hyundai Heavy Industries Co. Ltd.** 291 ITR 482 wherein the Court held:-

"7. A short question which needs to be answered in the present case is what are the profits reasonably attributable to the assessee's PE in India. In order to answer the above question we are required to analyse the scheme of the Act. Under Section 4 of the Act it is the total income of every "person" which is taxable. A foreign company which is not wholly controlled or managed in India is a non-resident so far as its residential status is concerned. Section 5(2) of the Act lays down that as far as a non-resident assessee is concerned scope of total income of such an assessee is confined to an income which accrues or arises in India or is deemed to accrue or arise in India and which income is received or deemed to be received by such foreign company. Therefore, it is clear that under the Act, a taxable unit is a foreign company and not its branch or PE in India. A non-resident assessee may have several incomes accruing or arising to it in India or outside India but so far as taxability under Section 5(2) is concerned, it is restricted to incomes which accrue or arise or is deemed to accrue or arise in India. The scope of this deeming fiction is mentioned in Section 9 of the Act. Therefore, as far as the income accruing or arising in India, an income which accrues or arises to a foreign enterprise in India can be only such portion of income accruing or arising to such a foreign enterprise as is attributable to its business carried out in India. This business could be carried out through its branch(s) or through some other form of its presence in India such as office, project site, factory, sales outlet etc. (hereinafter called as "PE of foreign enterprise"). It is, therefore, important to note that under the Act, while the taxable subject is the foreign general enterprise (for short, "GE"), it is taxable only in respect of the income including business profits, which accrues or arises to that foreign GE in India. The Income-tax Act does not provide for taxation of PE of a foreign enterprise, except taxation on presumptive basis for certain types of income such as those mentioned under Section 44BB, 44BBA, 44BBB etc. Therefore, since there is no specific provision under the Act to compute profits accruing in India in the hands of the foreign entities, the profits attributable to the Indian PE of foreign enterprise are required to be computed under normal accounting principles and in terms of the general provisions of the Income-tax Act. Therefore, ascertainment of a foreign enterprise's taxable business profits in India involves an artificial division between profits earned in India and profits earned outside India.

8. The Indian Income-tax Act, 1961 is concerned only with the profits earned in India and, therefore, a method is to be found out to ascertain the profits arising in India and the only way to do so is by treating the Indian PE as a separate profit center vis-a-vis the foreign enterprise (the Korean GE, in the present case). This demarcation is necessary in order to earmark the tax jurisdiction over the operations of a company. Unless the PE is treated as a separate profit center, it is not possible to ascertain the profits of the PE which, in turn, constitutes profits arising to the foreign GE in India. The computation of profits in each PE (taxable jurisdiction) decides the quantum of income on which the source country can levy the tax. Therefore, it is necessary that the profits of the PE are computed as independent units. However, in a case where Government of India has entered into a tax treaty with a foreign country (Korea, in the present case) then in relation to an assessee on whom such tax treaty applies, the provisions of the

Act shall apply only to the extent to which the provisions thereof are more beneficial to the assessee.

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12. There is one more aspect to be discussed. The attraction rule implies that when an enterprise (GE) sets up a PE in another country, it brings itself within the fiscal jurisdiction of that another country to such a degree that such another country can tax all profits that the GE derives from the source country - whether through PE or not. It is the act of setting out a PE which triggers the taxability of transactions in the source State. Therefore, unless the PE is set up, the question of taxability does not arise - whether the transactions are direct or they are through the PE. In the case of a Turnkey Project, the PE is set up at the installation stage while the entire Turnkey Project, including the sale of equipment, is finalized before the installation stage. The setting up of PE, in such a case, is a stage subsequent to the conclusion of the contract. It is as a result of the sale of equipment that the installation PE comes into existence. However, this is not an absolute rule. In the present case, there was no allegation made by the Department that the PE came into existence even before the sale took place outside India. Similarly, in the present case, there was no allegation made by the Department that the price at which ONGC was billed/invoiced by the assessee for supply of fabricated platforms included any element for services rendered by the PE. In the present case, we are concerned with assessment years 1987-88 and 1988-89. Therefore, we are not inclined to remit the matter to the adjudicating authority. We reiterate, in the circumstances, not all the profits of the assessee company from its business connection in India (PE) would be taxable in India, but only so much of profits having economic nexus with PE in India would be taxable in India. To this extent, we find no infirmity in the impugned judgment of the Tribunal. Accordingly, we are of the view that the Tribunal was right in holding that profits attributable to the Korean Operations was not taxable in view of Article 7 of CADT."

22. Therefore, Mr. Syali would be justified in his submission that even in a composite contract off-shore supply is to be segregated. On the contrary, here the endeavour of the Department is to club different contract as one which is clearly impermissible in the facts of this case. For the same reasons, the LO cannot be treated as PE of the assessee in India.

23. It will be of relevance to point out that Section 9 of the Act has been amended vide Finance Act, 2012. The following provisions have been added to Section 9 of the Act vide sub-Section (b) of Section 4 of the Finance Act, 2012 seeking to clarify the scope of clause (vi) of sub-Section (1) of Section 9 of the Act:-

"Explanation 4:-For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5- For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not -

(a) The possession or control of such right, property or information is with the payer;

(b) Such right, property or information is used directly by the payer;

(c) The location of such right, property or information is in India.

Explanation 6- For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;"

The above Explanations have been inserted with retrospective effect from 1.6.1976. The Memorandum explaining the Provisions in the Finance Bill, 2012, in the context of the above provisions states:-\

"Section 9(1)(vi) provides that any income payable by way of royalty in respect of any right, property or information is deemed to be accruing or arising in India. The term "royalty" has been defined in Explanation 2 which means consideration received or receivable for transfer of all or any right in respect of certain rights, property or information. Some judicial decisions have interpreted this definition in a manner which has raised doubts as to whether consideration for use of computer software is royalty or not; whether the right, property or information has to be used directly by the payer or is to be located in India or control or possession of it has to be with the payer. Similarly, doubts have been raised regarding the meaning of the term processed.

Considering the conflicting decisions of various courts in respect of income in nature of royalty and to restate the legislative intent, it is further proposed to amend the Income Tax Act in following manner:-

(i) To amend Section 9 (1) (vi) to clarify that the consideration for use or right to use of computer software is royalty by clarifying that transfer of all or any rights in respect of any right, property or information as mentioned in Explanation 2, includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

(ii) To amend section 9(1)(vi) to clarify that royalty includes and has always included consideration in respect of any right, property or information, whether or not

(a) The possession or control of such right, property or information is with the payer;

(b) Such right, property or information is used directly by the payer;

(c) The location of such right, property or information is in India

(iii) To amend section 9(1)(vi) to clarify that the term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

These amendments will take effect retrospectively from 1st June, 1976 and will accordingly apply in relation to the assessment year 1977-78 and subsequent assessment years."

On the basis of this amendment made effective from 1.6.1976, Mr. Parasaran argued that the above amendments are only clarificatory in nature depicting the Parliament intention viz;

(i) the medium through which the software is transferred itself will not affect the

taxability of the royalty payments made for the transfer of right to use or actual use of the software in India by a non-resident.

(ii) It is not necessary that the actual software be transferred to an Indian user or in fact used in India so long as the right to use has been transferred to a resident taxpayer for valuable consideration.

He, thus submitted that the question of "copyrighted article" or actual copyright does not arise in the context of software both in the DTAA and in the Income Tax Act since the right to use simpliciter of a software program itself is a part of the copyright in the software irrespective of whether or not a further right to make copies is granted. The decision of the Delhi Bench of the ITAT has dealt with this aspect in its judgment in **Gracemac Co. Vs. ADIT** 134 TTJ (Delhi) 257 pointing out that even software bought off the shelf, does not constitute a "copyrighted article" as sought to be made out by the Special Bench of the ITAT in the present case. However, the above argument misses the vital point namely the assessee has opted to be governed by the treaty and the language of the said treaty differs from the amended Section 9 of the Act. It is categorically held in **CIT Vs. Siemens Aktiengesellschaft**, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty. On the wording of the treaty, we have already held in **Ericsson** (supra) that a copyrighted article does not fall within the purview of Royalty. Therefore, we decide question of law no.1 & 2 in favour of the assessee and against the Revenue.

24. We may remark here that the Tribunal has held that the NIPL constitutes business connection within the meaning of Section 9 (1)(i) of the Act as it is a 100% subsidiary of the assessee company and by engaging itself in activities to support the assessee's main activities. However, even when such a business connection is found in the form of NIPL the contention of the assessee was that no income had accrued from such business connection and, therefore nothing was taxable in India and this contention is accepted by the Tribunal. We have mentioned this fact to put the record straight. Otherwise, in this question we are only concerned with LO as business connection as well as PE in India which we do not find to be so.

QUESTION OF LAW NO. 3 & 5

25. This aspect has already been discussed in detail by us in **DIT Vs. Ericsson**, 343 ITR 370 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 Vs. 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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"In *Advent Systems Ltd. v. Unisys Corpn*, 925 F. 2d 670 (3rd Cir. 1991), relied on by Mr. Sorabjee, the court was concerned with interpretation of uniform civil code which "applied to transactions in goods". The goods therein were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". It was held:

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser- readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.

That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

56. A fortiori when the assessee supplies the software which is incorporated on a CD, it has supplied tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty.

57. It is also to be borne in mind that the supply contract cannot be separated into two viz. hardware and software. We would like to refer the judgment of Supreme Court in **CIT Vs. Sundwiger EMFG Co.**, 266 ITR 110 wherein it was held:

"A plain and cumulative reading of the terms and conditions of the contract entered into between the principal to principal i.e., foreign company and Midhani i.e., preamble of the contract, Part-I and II of the contract and also the separate agreement, as referred to above, would clearly show that it was one and the same transaction. One cannot be read

in isolation of the other. The services rendered by the experts and the payments made towards the same was part and parcel of the sale consideration and the same cannot be severed and treated as a business income of the non-resident company for the services rendered by them in erection of the machinery in Midhani unit at Hyderabad. Therefore, the contention of the Revenue that as the amounts reimbursed by Midhani under a separate contract for the technical services rendered by a non-resident company, it must be deemed that there was a "business connection", and it attracts the provisions of Section 9(1)(vii) of the Income Tax Act cannot be accepted and the judgments relied upon by the Revenue are the cases where there was a separate agreement for the purpose of technical services to be rendered by a foreign company, which is not connected for the fulfillment of the main contract entered into principal to principal. This is not one such case and thus the contention of the Revenue cannot be accepted in the circumstances and nature of the terms of the contract of this case."

58. No doubt, in an annexure to the Supply Contract the lump sum price is bifurcated in two components, viz., the consideration for the supply of the equipment and for the supply of the software. However, it was argued by the learned counsel for the assessee that this separate specification of the hardware/software supply was necessary because of the differential customs duty payable.

59. Be as it may, in order to qualify as royalty payment, within the meaning of Section 9(1) (vi) and particularly clause (v) of Explanation-II thereto, it is necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copy right of a literary, artistic or scientific work. Section 2 (o) of the Copyright Act makes it clear that a computer programme is to be regarded as a 'literary work'. Thus, in order to treat the consideration paid by the cellular operator as royalty, it is to be established that the cellular operator, by making such payment, obtains all or any of the copyright rights of such literary work. In the present case, this has not been established. It is not even the case of the Revenue that any right contemplated under Section 14 of the Copyright Act, 1957 stood vested in this cellular operator as a consequence of Article 20 of the Supply Contract. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article"

60. Mr. Dastur is right in this submission which is based on the commentary on the OECD Model Convention. Such a distinction has been accepted in a recent ruling of the Authority for Advance Ruling (AAR) in **Dassault Systems KK 229 CTR 125**. We also find force in the submission of Mr. Dastur that even assuming the payment made by the cellular operator is regarded as a payment by way of royalty as defined in Explanation 2 below Section 9 (1) (vi), nevertheless, it can never be regarded as royalty within the meaning of the said term in article 13, para 3 of the DTAA.

This is so because the definition in the DTAA is narrower than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case.

61. We thus hold that payment received by the assessee was towards the title and GSM system of which software was an inseparable parts incapable of independent use and it was a contract for supply of goods. Therefore, no part of the payment therefore can be classified as payment towards royalty."

26. Notwithstanding the above, it was the submission of Mr. Parasaran , learned ASG that the agreement entered into for the installation of the GSM system is one composite agreement which cannot be segregated into off shore and on shore components as sought to be done by the assessee. He referred to the judgment of the Apex Court in

Hindustan Shipyards Vs. State of AP (2000) 6 SCC 579 wherein the Court held that following kinds of contracts are composite works contracts namely:-

"(i) The contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price"

27. He also referred to the recent judgment of the Supreme Court in **Vodafone BIFV Vs. Union of India**, 345 ITR 1 wherein it is held that the Department must, for the purposes of income tax "look at" the contract in question, that is to say, the intention of the parties must be examined on the basis of the express terms and conditions of the contract and not by giving it an artificial construction or by dissecting the said agreement. It was submitted that the learned Authority for Advance Rulings in **Roxar Maximum Reservoir Performance WLL**, A.A.R. No. 977/2010 and **Alstom Transport SA**, A.A.R. No. 958/2010 has applied the dictum of the Supreme Court in **Vodafone** in the context of composite contracts to arrive at the conclusion that the said contracts must be interpreted as a whole and not subdivided or dissected as was sought to be done in **Ishikawajima**. The Court was of the view that the judgment of a three Judge Bench of the Supreme Court's in **Vodafone** has "overruled" the **Ishikawajima** judgment of a two-Judge Bench of the Supreme Court. He, thus, contended that applying the tests of the Supreme Court of India in **Vodafone**, as applied also by the AAR in **Roxar and Alstom**, it is evident that the agreements entered into by the assessee with its Indian customers for setting up a GSM system have to be read as an indivisible whole and cannot be dissected or sub-divided. A submission was made that facts of the present case are slightly different from the case of **DITVs. Ericsson**, 343 ITR 370 (Delhi) decided on 23.12.2011.

28. It is difficult to accept the aforesaid submissions. Mr. Syali, has rightly contended that upto now, the arguments of the Department all throughout were that the issues involved in Nokia and Ericsson were common. Infact, this was admitted before the Tribunal as also their written submissions on record. It is admitted that everything is common to Ericsson except to the extent stated in the submissions, and the only submission on Royalty in the said submission is as under:

" It is most respectfully submitted that once it is established that there is a business connection and a Permanent Establishment through which the business activities of the company are carried out, and profits are attributable to the same the payments made for software would also form part of the same and there would be no need to deal with the same separately as "royalty" for the purposes of the DTAA or the Income Tax Act. However, in the event this Hon'ble Court is pleased to hold that any of the above criteria are unmet, it is submitted, without prejudice to the other arguments, that the payments made to the Respondent by its Indian customers for the license to use the copyrighted software amount to royalty"

29. Our reasoning given in **Ericsson** (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 undertaken 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 incorrect.

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

QUESTION OF LAW NO. 4

31. For the reasons stated in appeals preferred by the assessee, this issue is remitted back to the AO for fresh consideration.

32. As a result, insofar as appeals of the Revenue are concerned, these are dismissed.

ITA 1137/2006 & ITA 1138/2006

33. We have already noted above that as per the Special Bench NIPL is treated as PE of the assessee. On this basis, certain profits are attributed to this PE and the Tribunal has computed the income from Vendor Financing. These appeals are preferred by the assessee against those findings which were admitted on the questions of law:-

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

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

3. Without prejudice, if the answers to Q.1 & Q.2 are in affirmative, is there any attribution of profits on account of signing, network planning and negotiation of off-shore supply contracts in India and if yes, the extent and basis thereof?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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