IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "A", PUNE

BEFORE SHRI SHAILENDRA KUMAR YADAV,
JUDICIAL MEMBER, AND
SHRI G.S. PANNU, ACCOUNTANT MEMBER

ITA No.2535/PN/2012
A.Y. 2008-09

EPCOS AG
C/o EPCOS India Pvt. Ltd.,
E, 22-25, MIDC Satpur
Nashik - 422007

PAN: AAACE9787H Appellant

Vs.

DDIT (Intr. Taxn) –I, Pune Respondent

Appellant by	:Shri Paras S. Savla & Keerthiga Padmanabhan
Respondent by :	Smt. M.S. Verma
Date of Hearing:	23.01.2014
Date of order :	31.01.2014

ORDER

PER SHAILENDRA KUMAR YADAV, J.M:

This appeal has been filed by the assessee against the order of Dispute Resolution Panel, Pune, dated 04.09.2012 for A.Y. 2008-09 on the following grounds.

All the grounds of appeal are independent and without prejudice to each other

Ground No. 1 - Non-constitution of Permanent Establishment ('PE') of the Appellant in India

1.1 On the facts and in the circumstances of the case, the Deputy Director of Income Tax (International Taxation) - I, Pune, ('AO') erred in proposing and the Dispute Resolution Panel ('DRP') further erred in not interfering with the conclusion of the AO that the Appellant's Indian Subsidiary constitute its 'Business Connection' in India under Section 9(1)(i) of the Income-tax Act, 1961('the Act') or a 'Permanent

Establishment' ('PE') in India under various provisions of Article 5 including Articles 5(1), 5(2), 5(5) and 5(6) of the India-Germany Tax Treaty ('Tax Treaty').

1.2 The AO and the DRP failed to appreciate that the Appellant operates entirely from outside India, has no fixed place of business in India as envisaged under Section 9(1)(i) of the Act or Article 5(1) or 5(2) of the Tax Treaty directly or in the form its Indian Subsidiary and further Article 5(5) and 5(6) of the Tax Treaty do not apply to its case as they relate only to local Indian agents engaged in buying and selling goods in India on behalf of their Overseas Principal which is not the fact in the case of the Appellant and the Appellant claims relief accordingly.

Ground No. 2 - No attribution of income deemed to accrue / arise in India possible to the alleged PE of the Appellant in India

2.1 Without prejudice to the above and on the facts and in the circumstances of the case, the AO erred in proposing and the DRP further erred in not interfering with the AO's conclusion that the Appellant's India source income taxable on deemed accrual basis is attributable to the alleged PE in India under Article 7 of the Tax Treaty.

2.2 The AO and the DRP failed to appreciate that since the Appellant operates entirely from outside India (Germany) and carries out no operations in India, no income can be attributed to the alleged PE in India under Article 7 of the Tax Treaty, and even otherwise pursuant to Article 7(3) of the Tax Treaty, the taxation on gross basis at higher rates of 20% on gross basis under Section 115A / 44D of the Act is unwarranted and the taxation ought to be at 10% on gross basis under Articles 11 and 12 of the Tax Treaty as offered in the Return of Income and the AO be directed accordingly.

Ground No. 3 — Denial of recourse to Non-discrimination clause - Article 24 of the Tax Treaty denied

3.1. Without prejudice to the above and on the facts and in the circumstances of the case, the AO has erred in proposing and the DRP has further erred in not interfering with the AO's conclusion of not granting benefit of Article 24 of the Tax Treaty relating to Non-Discrimination to the facts of the Appellant's case.

3.2. The AO and the DRP failed to appreciate that under Article 24 - Non-Discrimination of the Tax Treaty, the Appellant and its alleged PE in India cannot be subjected to taxation requirement which is more burdensome then the taxation of Resident in India for its alleged PE and the AO be directed to tax the income on net basis based on audited financial statements filed before him at assessment stage as against 20% on gross basis under Section 115A/44D of the Act.

Ground No. 4 - Erroneous charging of interest under Section 234B of the Act

4.1 Without prejudice to the above and on the facts and in the circumstances of the case and in law, the AO erred in charging Interest of Rs. 1,13,01,962 under Sections 234B of the Act while computing the demand payable pursuant to the impugned assessment order.

4.2 The AO failed to appreciate that the Appellant is not liable to pay any advance tax under Section 209 of the Act which is payable on income post reduction of entire income-tax deductible or collectible at source as is the case of the Appellant and not the actual tax deducted or collected at source and the AO be directed to delete the interest charged under Section 234B of the Act.

Ground No. 5 - Lack of adequate opportunity

5.1 Without prejudice to the above and on the facts and in the circumstances of the case and in law, the AO erred in not granting sufficient opportunity to the Appellant before passing the order under Section 144C(1) of the Act and the DRP further erred in not considering the objections / submissions of the appellant while giving directions under Section 144C(5) of the Act and the said orders / directions being passed in violation of the principles of natural justice be kindly quashed or set aside.

The Appellant craves leave to add, alter, amend or withdraw all or any of the Grounds of Appeal herein and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing.

2. At the outset of hearing, the learned Authorized Representative did not press grounds of appeal Nos.3 and 5, so

they are being dismissed as not pressed. Regarding grounds of appeal No.1, the assessee has raised as under:

> "Ground No. 1 - Non-constitution of Permanent Establishment ('PE') of the Appellant in India
>
> 1.1 On the facts and in the circumstances of the case, the Deputy Director of Income Tax (International Taxation) - I, Pune, ('AO') erred in proposing and the Dispute Resolution Panel ('DRP') further erred in not interfering with the conclusion of the AO that the Appellant's Indian Subsidiary constitute its 'Business Connection' in India under Section 9(1)(i) of the Income-tax Act, 1961('the Act') or a 'Permanent Establishment' ('PE') in India under various provisions of Article 5 including Articles 5(1), 5(2), 5(5) and 5(6) of the India-Germany Tax Treaty ('Tax Treaty').
>
> 1.2 The AO and the DRP failed to appreciate that the Appellant operates entirely from outside India, has no fixed place of business in India as envisaged under Section 9(1)(i) of the Act or Article 5(1) or 5(2) of the Tax Treaty directly or in the form its Indian Subsidiary and further Article 5(5) and 5(6) of the Tax Treaty do not apply to its case as they relate only to local Indian agents engaged in buying and selling goods in India on behalf of their Overseas Principal which is not the fact in the case of the Appellant and the Appellant claims relief accordingly."

2.1 First issue is with regard to whether assessee's Indian subsidiary constitute its business connection in India u/s. 9(1)(i) of I.T. Act, 1961 ('the Act') or a Permanent Establishment ('PE') in India under various provisions of Article 5 including Articles 5(1), 5(2), 5(5) and 5(6) of the India-Germany Tax Treaty ('Tax Treaty') At the outset of hearing, the learned Authorized Representative has pointed out that this issue is covered by the assessee's own case in ITA No.1413/PN/2010 for A.Y. 2006-07 by following similar issue in A.Y. 2003-04 observing as under:

> "We have heard both the parties and perused the orders of the Revenue as well as the decision relied upon by the learned Counsel. It is a fact that there is a decision by this Tribunal in the case of the assessee for the assessment year 2003-04 in the background of the fact that order of the

CIT(A) was not accepted by the Revenue. There is no DRP for the period relevant to the assessment year 2003-04. Therefore, the order then challenged was passed by toe CIT (A) and the said order was confirmed by the Tribunal upholding the non-existence of PE. In this regard, we find it relevant to reproduce paras 39 to 41.1 of the Tribunal's order as under:

> "Is it necessary that the FE can only be said to exist, under the basic rule, when core business activity is carried out by the PE?
>
> 39. We quite agree with the stand of the Revenue authorities to the extent that as long as an economic activity is carried out in the fixed place of business available to foreign enterprise, whether such an activity is a core activity or a peripheral activity, it has to be concluded that the foreign enterprise has a PE in the source jurisdiction. Model Convention Commentary states that the activity carried out by the PE may not be a productive character, though the commentary does recognize that it could perhaps be argued that in the general definition, some mention should also be made to the other characteristic of the PE, namely that the establishment must have a productive character - i.e. contribute to the profits of the enterprise. However, in the present definition, this course has not been taken, late Prof. Vogel also concurred with this school of thought and observed that "... the PE need not be a branch in the nature of facility engaged in activities of the same type as those of the head office organization, nor need the place of business directly contribute to enterprise's profits' and 'all that its business must do is to serve the enterprise's overall purpose, but it must be an activity". The question, however, is that the activity must be of the business of the tax payer company, and not of the independent subsidiaries of such a taxpayer company. On the facts of the case before us, no part of the work of EPCOS AG was carried out in India. The e-mails and letters were sent from outside India, and at best Indian subsidiaries acted upon the advices so given in the e-mails and letters in India. That action of the subsidiaries cannot alter the situs of the activities of the Epcos AG / Does mere existence of PE leads to taxability of income in source country?
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> 40. It is also important to bear in mind that a non-resident company having a PE in India, by itself, does not lead to taxability in India; there must be some

profit attributable to such a PE which alone could be taxed in India because of the existence of the PE. When the PE carries on an activity which does not serve overall purpose of the foreign enterprise, or which does not contribute to profits of the enterprise, the existence of such a PE is wholly academic and does not have any tax implications in the source jurisdiction. To that limited extent, there is an inherent contradiction in the OECD approach inasmuch as on one hand PE provides threshold limits for triggering taxation in the source country, on the other hand, the existence of the PE is decided de hors the activity in the absence of which taxability of profits in the source country cannot be triggered at all. On the face of it, when a PE is not engaged in a critical activity having some contribution to overall profits of the enterprise or a revenue generating activity, the exercise to ascertain whether or not 8 PE is in existence is a meaningless ritual and an empty formality. Viewed in this perspective, and bearing in mind the fact that by no stretch of logic it could be held that any significant or critical business activity by the EPCOS AG was carried out in India, even if there is a PE in India, that will be wholly academic and will not lead to any taxability of income. Not only the work done in India, if at all, did not constitute significant or "critical business activity, the assessee company did not earn any revenues as a result of the activities so carried out by the employees of Indian subsidiaries and, therefore, no part of the revenues actually generated by the assessee company could be said to be attributable to the PE. The question of existence of PE of the assessee company, in these circumstances, has no impact of taxability of the assessee company.

41. The requirements of exclusion clause under art. 15(5) also highlight this aspect of profit attribution. While we we're examining interplay between art. 12 and art. 7, we had noticed that this exclusion clause has twin requirements of (a) existence of the PE through which business is carried out; and of (b) existence of effective connection between such a PE and the rights, properties and contracts in respect of which 'royalties' and 'fees for technical services' are paid. That would mean that only such 'royalties' and fees for technical services' are excluded from the scope of art. 12(1) and (2) as are attributable to the PE through which business is carried on by the enterprise. In other words, the taxability under art. 12

shifts to taxability under art. 7 only in respect of 'royalties' and 'fees for technical services' which are attributable to the PE in question. In case an assessee receives 'royalties' and 'fees for technical services' but these receipts do not have an effective nexus with the PF, and are not, therefore, attributable to the PE, the exclusion clause under art. 15(5) as also taxability under art. 7(1) and (2), is not triggered.

41.1In the light of these discussions, in our considered view, the assessee company did not have any PE in India, much less a PE to which subject 'royalties' and 'fees for technical services' can be attributed. In terms of the India-Germany DTAA, India does not have right to tax these receipts as business profits under art. 7. Of course, in the light of our finding that no revenues earned by the assessee company could be said to be attributable to the PE, even if one was to come to the conclusion that a PE existed, no taxability could arise under art. 7. The assessee has offered the royalties and fees for technical services for taxability in India under art. 12, and, to that extent, admitted tax liability exists. The overzealous approach of the AO has been rightly rejected by the CIT (A). We approve and confirm the stand of the CIT(A), and decline to interfere in the matter."

9. Considering the above, we have also examined the comparability of the facts of the case for this year vis-a-vis the assessment year 2003-04. It is a fact that neither the AO, nor the DRP, nor the present CIT-DR were able to demonstrate as to whether the facts of the current year are different in any form with that of assessment year 2003-04. Merely, the DR mentioned that nobody has gone into that issue, therefore, the matter should be set aside. We are unable to appreciate this line of argument of the CIT-DR for the simple reason that it is the responsibility of the AO first of all to follow the jurisdictional decision of the Tribunal in assessee's own case for the AY 2003-04. The same was not followed and surprisingly, they have not even distinguished. They simply ignored stating that the said order- is not accepted by the Revenue and the matter is pending before the Hon'ble High Court of Bombay. Considering the above, we are of the considered opinion that there is no case for sending the files to the Revenue. In fact it is the case of the assessee that the facts are identical vis-a- [1] vis the facts of the assessment year 2003-04. In these circumstances, we are of the opinion that the decision comprised in para 41.2 is equally relevant for the .year under consideration in

> respect of Ground No. 1. Accordingly, Ground No. 1 raised by the assessee is allowed."

2.2 Nothing contrary was brought to our knowledge on behalf of revenue. Facts being similar, so following the same reasoning, we are not inclined to concur with the finding of DRP. We are of the view that the assessee did not have any PE in India, much less a PE to which subject royalties and fees for technical services could be attributed. In terms of India-German DTAA, India does not have right to tax these receipts as business profit under Article 7. In the light of above finding that no revenue earned by the assessee could be said to be attributable to PE, even if one was to come to the conclusion that a PE existed, no taxability could arise under Article 7. The assessee has offered the royalties and fees for technical services for taxability in India under Article 12A and to that extent, admitted tax liability exists. This approach of the Assessing Officer was rejected by the CIT(A) in A.Y. 2006-07 for the reasons discussed above. Accordingly, the issue in ground No.1 is allowed as discussed above.

3. Next issue is with regard to non attribution of income deemed to accrue or arises in India. In this regard again the learned Authorized Representative has submitted that this issue is also covered in favour of the assessee (relating to non-attribution of income), the Tribunal has decided the issue vide para 10 of its order in assessee's own case for A.Y. 2006-07, wherein the issue has been decided in the similar facts and circumstances for A.Y. 2003-04, by observing as under:

> "Conclusion on the second issue i.e. taxability @ 20 per cent in terms s. 44DS r/w s.115A in case PE is found to be in existence:
>
> 47. In our considered view, in terms of Indo German tax treaty provisions, it will have to be demonstrated that such royalties and fees for technical services ha e a live economic

nexus with the PE and only then exclusion clause under art. 12(5) as also taxability under arts. 7(1) and 7(2), will come into play. It is only after these royalties and fees for technical services are so included in the business profits attributable to the PE that the provisions of sec. 44D and USA can be invoked. Therefore, even if we are to hold that the taxpayer had a PE in India, unless there is a categorical finding that entire receipts were attributable to that PE, entire business receipts of the taxpayer sourced from India would not have been taxable in India under art. 7. The provisions of s. 44D and s.115A do not, therefore, come into play only because there is a PE in India. Taxability under the domestic law:

48. The next thing to be examined is taxability of royalties and fees for technical services' earned by the assessee company in terms of the provisions of the Indian IT Act, 1961.

49. There is no dispute on the basic facts. The amounts received by the assessee company on this account meet the definition of 'royalties' and of fees for technical services' under S.44D which, in turn, refers to Expln.2 to s. 9(l)(vi) respectively. Accordingly, the limitation on deductions, as set out in 5.'MD, does apply on the facts of the case, and entire amount is to be taxable on gross basis. However, in view of the provisions of s.115A, the rate of tax on such income will indeed be 20 percent.

50. In view of the above discussions, the taxability of amounts received by the assessee company on account of 'royalties' and 'fees for technical services', on the facts of this case and under the Indian IT Act, will be @ 20 percent on gross basis, That aspect of the matter is, however, academic since we have already held that, on the facts of this case, source country does not have the right to tax income in question, except under art. 12(2) of the tax treaty and at a rate not exceeding 10 per cent. The assessee has already accepted tax liability to that extent, and there is no dispute so far as taxability under art. 12(2) is concerned."

11. Considering the above, the issue raised by the assessee in Ground No 2 is covered in favour of the assessee and the taxation on gross basis at higher rate of 20% 'under section 115A read with 44D of the Act are unwarranted-and taxation is ought to be at 10% on gross basis under Article 12(2) of the Tax Treaty as offered in the return of income. Accordingly, Ground No. 2 is allowed."

3.1 Nothing contrary was brought to our knowledge on behalf of revenue. Facts being similar, so following the same reasoning, we are not inclined to concur with the finding of DRP and the same is set aside. According to us, taxation at gross basis at higher rate of 20% u/s.115A r.w.s. 44D of Act are unwarranted and taxation has to be at 10% on gross basis under article 12(2) of the Tax Treaty as offered in the return of income. Accordingly, this ground of assessee is allowed.

4. Next issue is with regard to charging of interest under the provisions of section 234B of I.T. Act, which is consequential.

5. In the result, appeal filed by the assessee is partly allowed.

Pronounced in the open Court on this the day 31st of January, 2014.

Sd/-	Sd/-
(G.S. PANNU)	(SHAILENDRA KUMAR YADAV)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Pune, Dated: 31st January, 2014
GCVSR

Copy to:-

1) Assessee
2) Department
3) The DRP, Pune
4) The DDIT (Intl. Taxn)-I, Pune
5) The DR, "A" Bench, I.T.A.T., Pune.
6) Guard File

By Order

//True Copy//

Senior Private Secretary,
I.T.A.T., Pune